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ROYAL COMMISSION
ON
TRANSPORTATION

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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, Ontario,
Wednesday,
April 19, 1950

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
WEDNESDAY
APRIL 19, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN

HAROLD ADAMS INNIS - COMMISSIONER

HENRY FORBES ANGUS - COMMISSIONER

G.R. Hunter
Secretary

P.L. Belcourt
Asst. Secretary

COUNSEL APPEARING:-

F.M. Covert, K.C.	}	Royal Commission on Transportation
G.C. Desmarais, K.C.		
H.E. O'Donnell, K.C.	}	Canadian National Railways
N.J. MacMillan		
H.C. Friel, K.C.		
F.C.S. Evans, K.C.	}	Canadian Pacific Railway
I.D. Sinclair		
C.W. Brazier	)	Province of British Columbia
J.J. Frawley, K.C.	)	Province of Alberta
M.A. MacPherson, K.C.	)	Province of Saskatchewan
C.D. Shepard	)	Province of Manitoba
J. Paul Barry	)	Province of New Brunswick
Frank D. Smith, K.C.	)	Province of Nova Scotia
M.L. Rapoport	}	Canadian Automotive Trans- portation Association

Ottawa, Ontario
Wednesday, April 19 1950.

MORNING SESSION

MR. FRAWLEY: My lord, before Mr. O'Donnell resumes I should like to refer to a question that was asked from the bench on two or three occasions and that is with respect to the issues of common stock which have been sold by the American class 1 railroads during recent years. I took the matter up with the finance bureau of the Interstate Commerce Commission, and I now wish to file a letter addressed to myself from Mr. C. E. Boles, director of the bureau of finance of the Interstate Commerce Commission to which is attached a tabulation. Mr. Boles' letter is very short and says:

" In reply to your letter of March 13, 1950 inquiring as to the amount of common stock sold by Class I railroads from 1930 to date to provide new money you are advised that in recent years as the tabulation attached will show, relatively small amounts of common stock have been sold by Class I roads for the purpose of providing new money.

The tabulation shows the citation referring to the Interstate Commerce Commission reports, date of order, name of the railroad, and the amount of stock authorized to be sold, also amount issued."

The Commissioners will find that there was a very small amount of common stock sold, as Mr. Boles advises. In 1930 the Chesapeake and Ohio sold a \$38 million issue, and in 1930 the Pennsylvania sold \$18 million. The others are hardly worth mentioning. The New York Central \$7,500,000 in 1930, the Chicago & Illinois Midland Railway Company \$1 million in 1940, the Chicago & Illinois Midland \$1 million in 1944, the Central Railroad Company of Pennsylvania

1. The first part of the paper

is devoted to a discussion of

the results of the experiments

conducted in the laboratory

and the results of the field

work. The results of the

work are presented in the

conclusion

of the paper. The results of

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\$750,000 in 1946, and the Texas and Northern Railway Company \$550,000 in 1948. That will be Exhibit 264.

EXHIBIT NO. 264: Letter from C.E. Boles, director, bureau of finance, I.C.C., with attached tabulation of common stock sales by U.S. railroads.

THE CHAIRMAN: What is the writer's name?

MR. FRAWLEY: Mr. C. E. Boles, director, bureau of finance, Interstate Commerce Commission. Then, my lord, I wish to file a further statement arising out of Mr. Jefferson's cross-examination. I will make a very brief reference to it. At page 16045, volume 81, Mr. Jefferson was asked by me :

"Q. As to Winnipeg and west, it is a fact, is it not, that for a number of years there were a number of commodities where you did apply the Montreal rate as a maximum to intermediate points, such as Winnipeg and Regina?"

Mr. Jefferson said;

"A. I don't know. If you could give me a reference to some commodity I could check it up."

Further on I asked him:

"Q. Now, Mr. Jefferson, I would ask you to be good enough to have that matter looked up for me, even if I have to come back to it. In other words, I would like to know when that adjustment was removed.

A. I can't look it up without some information as to what commodity you are talking about.

Q. Even to begin to make a search of the matter you would have to have a commodity?

A. I wouldn't know where to begin."

Therefore I am now offering to the Commission and to Mr. Jefferson a statement which indicates the thing I was

talking about. It shows that there was for some years, and down in some cases to October 1, 1949, a parity, that is, that the rate from Vancouver to Toronto, the so-called water compelled, Panama Canal compelled rate, from Vancouver to Toronto was granted to Winnipeg and even to Regina on fish dried, fish canned, hops and crude cocoanut oil. That will be Exhibit No. 265.

EXHIBIT NO. 265: Statement showing water- -
compelled rate Vancouver-
Toronto granted to intermediate
points on certain articles.

MR. EVANS: Perhaps I should say that I haven't had an opportunity of checking these rates that my friend, Mr. Frawley, has put in. I should also like to say with regard to Exhibit 264 that it might have been helpful if in putting in the statement as to the amount of stock issued by United States Railways there had been some indication as to why stock issues were so low as they were. I think it is quite clear that they were in very great difficulties financially for many years.

MR. FRAWLEY: Fortunately Mr. Boles' tabulation was so carefully prepared that he has given us the judgment of the I.C.C. in each case approving the issue so that it is there in 162 I.C.C., 240 I.C.C., and so on, as the exhibit shows.

THE CHAIRMAN: Are there any reasons given for the issue?

MR. FRAWLEY: Yes, as I recall; I simply checked to see that the reference had to do with the approval of the Commission. They write a regular judgment, my lord, indicating approval and why they are granting approval to the issue.

THE CHAIRMAN: Why they are granting approval.

MR. FRAWLEY: Oh yes, the whole thing is discussed. I can get the actual books and discuss them with the

Commission, but a hurried reading of them indicates the reasons why approval for the sale of the stock was granted.

MR. EVANS: I wasn't thinking of that at all.

THE CHAIRMAN: If we knew why it was granted we would know why the railway applied for it.

MR. EVANS: I have given the wrong impression. What I meant to say was why there were not more stock issues applied for. My point is it would be more helpful if we knew the reason why more applications for approval of issues were not made.

THE CHAIRMAN: There are two different things there and I think they would be both useful.

MR. FRAWLEY: I have certainly done my best. I have gone to the proper source; and this is the whole story with the I.C.C. references attached.

THE CHAIRMAN: Are you in a position, Mr. Evans, to go further and say why more applications were not made?

MR. EVANS: I think it is unquestioned. I am going to refer the Commission to a book published in 1949 which discusses that, and it indicates that one of the principal reasons is the time lag and delay in getting increases in rates and also the rather limited increases they got.

THE CHAIRMAN: If you bring that along we will like to have it.

MR. SMITH: Mr. Chairman, you may remember that you requested me to endeavour to obtain further information from the Interstate Commerce Commission in respect of the exceptions to horizontal increases under the judgment in Ex Parte 162, and I have complied with your request. Accordingly on the 8th of April I wrote a letter to Mr. Hunter, the secretary of the Commission, enclosing a comparison showing the various exceptions by commodities to the standard increases under that judgment as well as an

original letter from Mr. W. H. S. Stevens, director of the bureau of transport economics and statistics, Interstate Commerce Commission, the letter being dated March 30, 1950, and in which he said:

" "In accordance with your request, the distribution of the commodities and classes and related revenues in your specified "excepted" groupings have been reviewed. In the judgment of the Bureau, these distributions, as well as the total revenues for all these excepted items, may be said to fall within the area of reasonable estimates. You will understand, of course, that this is not an official figure inasmuch as the Commission has made no estimates such as those included in your tabulation."

In the tabulation the various items are shown. So I propose, my lord, to tender the original letter to Mr. Hunter, the original letter from Mr. Stevens and the attached statement as one exhibit. Mr. Belcourt is getting the original letters and perhaps we could have a number assigned to it now.

THE ASSISTANT SECRETARY: 266.

<u>EXHIBIT NO. 266:</u>	Statement of exceptions to horizontal increases under judgment in Ex Parte 162, with attached correspondence.
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MR. SMITH: There is one further statement which I wish to tender as an exhibit. I have spoken to Mr. Covert, my lord. It is a statement prepared by the Interstate Commerce Commission which contains selected income items by regions and districts of class I steam railways. It shows among other things net railway operating income, net income, federal income taxes and the dividend appropriations of all class I railways in the United States for

the years 1948 and 1947. I think it would be very useful for the Commission to have it. That will be Exhibit 267.

MR. COVERT: It consists of two pages?

MR. SMITH: The original consists of one page.

<u>EXHIBIT NO. 267:</u>	Selected income items, Class I roads, U.S.A.
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MR. EVANS: May I file as Exhibit 268 the annual report of the Canadian Pacific Railway Company for the year 1949. Copies have been distributed to my friends and I think also to the secretary.

<u>EXHIBIT NO. 268:</u>	Annual report, Canadian Pacific Railway, 1949.
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(Page 20024 follows)

THE CHAIRMAN: All right, Mr. O'Donnell. I think your case comes on next.

MR. O'DONNELL: May it please the Commission, on March 23 last, during the evidence of Mr. Cooper, your lordship, speaking of that portion of Mr. Gordon's submission which appears at pages 16 and 17 thereof under the heading "Surplus Earnings", which includes a reference to the so-called rate stabilization fund, to use your lordship's own words, asked me "if it would be all right to withdraw this contentious part of Mr. Gordon's statement..." Acting on your lordship's suggestion I indicated that that would be possibly the way to handle the matter and not to bother the Commission further with it. I stated in part that its purpose had been misconstrued, that large surpluses were not expected by the Canadian National railways, "that there was no intention to build up a huge fund" and that it related to relatively small sums; and I think I said that I think possibly the Chairman was right when he indicated that it might be well just to forget the whole thing. At this earliest opportunity - the Commission will remember that the Canadian National Railways Case was interfered with in order to proceed with the subject of the Crow's Nest Pass rates - I have to report that I discussed this suggestion of your lordship with my principals and that I have been authorized to accept your lordship's proposal and to declare that the portion of Mr. Gordon's statement to which I have just referred, the paragraph under the heading of "Surplus Earnings" on page 16 and at the top of page 17 is withdrawn.

THE CHAIRMAN: The whole of it?

MR. O'DONNELL: The whole thing is withdrawn,

and is to be deleted and treated as if it had not been contained in Mr. Gordon's statement as it was originally presented to the Commission.

THE CHAIRMAN: I notice that by the last sentence in that paragraph you at that time were asking us to recommend the proposals.

MR. O'DONNELL: Merely a recommendation; that is all. We are not asking for that now.

THE CHAIRMAN: You were asking us to recommend that the proposals which were contained in that paragraph should be adopted?

MR. O'DONNELL: That is right.

THE CHAIRMAN: Now, you no longer ask for that recommendation?

MR. O'DONNELL: We withdraw the entire paragraph. We ask for no recommendation at all with respect to it. I might say, my lord, that this is done in order to shorten the hearings and in order to dispel the fears, unfounded as they are, of those who have not regarded the suggestion with favour. Mr. Gordon felt that the proposal would meet with favour particularly from the provinces; but in the light of their misgivings he is quite content to abide by your lordship's proposal, that the entire paragraph which incidentally forms no integral part of the real relief sought and which is quite severable from the main submission, is withdrawn and is to be considered to be definitely deleted from the statement.

THE CHAIRMAN: The whole thing is to go out, as to what your Board should do with surplus earnings?

MR. O'DONNELL: That is right.

THE CHAIRMAN: You do not want any recommendation?

MR. O'DONNELL: No recommendation.

THE CHAIRMAN: The Board will be left free as it is today?

MR. O'DONNELL: Under the Statutes as they stand today.

It occurs to us that, before continuing with the evidence of Mr. Fairweather it would be helpful and useful at this point, in compliance with the suggestion which you, Mr. Chairman, have on several occasions put forth, particularly when Mr. Fairweather was here last, as indicated in Volume 103 at pages 19121 to 19123 of the Transcript, to make a brief statement indicating generally the situation of the Canadian National Railways and the lines of railway it operates and which are comprised within what is termed the Canadian National Railways System. I think it might take a few moments but it will really be useful and helpful.

As to the early history of the Canadian National Railway Company, the Canadian National Railways Act, 1919, Chapter 13, provided for the incorporation of Canadian National Railway Company. Section 1 authorized the Governor-in-Council to nominate such persons as might be deemed expedient, not less than five, nor more than fifteen, to be Directors of the Company thereby incorporated, and upon such nomination being made, the persons so nominated and their successors, should be and were thereby incorporated as a Company under the name of "Canadian National Railway Company". The preamble stated that whereas His Majesty had acquired the control of the Canadian Northern Railway System, it was expedient to provide for the incorporation of a company under which the railways and works of that System might be consolidated and, together with the Canadian Government

Railways, operated as the National Railway System.

THE CHAIRMAN: What were the Canadian Government Railways?

MR. O'DONNELL: I am coming to that in a few moments, my lord.

THE CHAIRMAN: All right.

MR. O'DONNELL: Complete control of the Canadian Northern had passed to the Government under the arbitration award of May 25, 1918. Nominal control had already been acquired under the terms of the Acquisition Agreement dated October 1, 1917. The first Board of Directors representing the Government was appointed on September 6, 1918 and by P.C. 2854, dated November 20, 1918, the persons from time to time comprising the Board were appointed a Board of Management of Canadian Government Railways. By Order-in-Council P.C. 3122, dated December 20, 1918, use of the name "Canadian National Railways" as a collective or descriptive designation in lieu of the names "Canadian Northern Railway System" and "Canadian Government Railways" was authorized.

THE CHAIRMAN: That was in advance of the Statute?

MR. O'DONNELL: Yes, my lord; that is right ; that is the Canadian National Railways Act itself. The Government did not nominate Directors of the Canadian National Railway Company until October 4, 1922, when by Order-in-Council P.C. 2904, Sir Henry W. Thornton and others were appointed and incorporation became effective. While the Statute was passed in 1919, the nomination of the Directors did not take place until 1922 and that, under the Statute was the date from which incorporation became effective.

In the meantime much had happened. In March 1919 the Minister of Railways had been appointed Receiver of the Grand Trunk Pacific Railway Company; and by P. Order-in-Council P.C. 1595 dated July 12, 1920, the operation of this Company and its subsidiaries was entrusted to those persons who then, or might thereafter, comprise the Board of Directors of the Canadian Northern Railway Company. In 1920, the Government had acquired the capital stock of the Grand Trunk Railway Company of Canada. Thus when the Canadian National Railway Company finally came into being, the Government had on its hands four distinct systems, those of the Canadian Government Railways, the Grand Trunk Railway Company, the Canadian Northern Railway Company, and the Grand Trunk Pacific Railway Company, each of which Systems was comprised of many constituent and subsidiary companies.

THE CHAIRMAN: Would you mind reading them again, Mr. O'Donnell?

MR. O'DONNELL: The four are the Canadian Government Railways, the Grand Trunk Railway Company, the Canadian Northern Railway Company, and the Grand Trunk Pacific Railway Company.

THE CHAIRMAN: Should you tell me now or is this the time to tell me what constituted the Canadian Government Railways?

MR. O'DONNELL: I can tell you, my lord.

THE CHAIRMAN: If you are coming to it, let it go for the time being.

MR. O'DONNELL: The Canadian Government Railways at that time consisted of the Intercolonial Railway, the National Transcontinental Railway, the Lake Superior Branch

Line from the Grand Trunk Pacific Railway, the Prince Edward Island Railway and the Hudson Bay Railway. I intend to list them later.

THE CHAIRMAN: Very well.

MR. O'DONNELL: As I said, each of those systems was ocomprised of many constitutent and subsidiary companies. Consolidation had now assumed much greater significance.

On October 4, 1922, the same day on which Sir Henry W. Thornton et al had been appointed Directors of Canadian National Railway Company, the identical group were appointed Directors of the Grand Trunk Railway Company of Canada. On October 10, 1922, the same group were appointed Directors of the Canadian Northern Railway Company, and by virtue of this appointment became entrusted with the operation of the Grand Trunk Pacific Railway which was still under the receivership of the Minister of Railways and which was to continue under this receivership until May 31, 1927.

On January 20, 1923, Order-in-Council P.C. 115 entrusted the Canadian Government Railways to the Canadian National Railway Company for management and operation. Ten days later, on January 30, 1923, Order-in-Council P.C. 181 authorized and approved the amalgamation of the Grand Trunk Railway Company of Canada with Canadian National Railway Company. The authority for this procedure was contained in Section 21 of the Canadian National Railways Act, 1919, Chapter 13, and Section 151 of the Railway Act, 1919, Chapter 68, Section 151, now revised Statutes of Canada, Chapter 170, Section 151.

The amalgamated companies took the name of

"Canadian National Railway Company" and thus Canadian National Railway Company became a railway Company owning and operating the system formerly called the "Grand Trunk Railway System". Thus was laid the basis for consolidation much as it exists today and this was accomplished as set forth above by amalgamation, entrustments and the appointment of identical Boards of Directors.

Canadian National Railway Company, as such, did not own a single line of railway in its own right until amalgamation. It now owns in its own right - -

THE CHAIRMAN: Would you give me the year again, please?

MR. O'DONNELL: 1923.

THE CHAIRMAN: All right.

MR. O'DONNELL: It now owns in its own right, in addition to the properties acquired by amalgamation, certain other lines such as the Gaspe Lines; the St. John and Quebec Railway; Quebec, Montreal & Southern Railway and others, most of which were acquired in the year 1929. Some branch lines have been constructed. The acquisitions and branch lines are not significant when compared with the properties acquired by amalgamation.

As to the Capital stock, Section 3 of the Canadian National Railways Act provided that the Governor-in-Council might declare that the Canadian National Railway Company "shall have a capital stock, with or without shares, to such amount as made from time to time be deemed expedient." Order-in-Council P.C. 181, above mentioned, declared that the Canadian National Railway Company as constituted by amalgamation should have a capital stock of \$180,424,327 and that one share should be issued to the Minister of

Finance for the whole of such amount, being all the voting capital stock of the Grand Trunk Railway Company of Canada. Upon the single share being registered in the name of the Minister of Finance, the capital stock of the Grand Trunk Railway Company of Canada referred to above, was surrendered to the amalgamated Company, Canadian National Railway Company.

There was no change in this position until the Canadian National Railways Capital Revision Act was passed in 1937. Section 3 of this Act authorized the Minister of Finance to surrender to Canadian National Railway Company, for cancellation, the outstanding capital stock of that Company, having the par value of \$180,424,327. Section 4 authorized the Minister of Finance to surrender to the Canadian Northern Railway Company, for cancellation, 820,006 shares of the outstanding capital stock of that company, having the par value of \$82,000,600.

(Page 20034 follows)

Section 5 authorized the Minister of Finance to transfer to Canadian National Railway Company 180,000 shares of the outstanding capital stock of the Canadian Northern Railway Company (being the residue of its stock outstanding after the cancellation referred to), having the per value of \$18,000,000 in exchange for 1,000,000 no par value shares of the capital stock of Canadian National Railway Company with the initial stated value of \$18,000,000, the issue of which shares was thereby authorized to be made with the approval of the Governor in Council.

The shares were issued accordingly and represent the capital stock of Canadian National Railway Company as of this date.

COMPANIES AND RAILWAY COMPRISING THE
CANADIAN NATIONAL RAILWAY SYSTEM IN 1923.

1. Canadian Government Railways

The management and operation of the Canadian Government Railways was entrusted to the Canadian National Railway Company by P.C. 115 referred to above. They comprised:

The Intercolonial Railway

The National Transcontinental Railway

The Lake Superior Branch leased from the
Grand Trunk Pacific Railway

The Prince Edward Island Railway

The Hudson Bay Railway

THE CHAIRMAN: This is just entrustment.

MR O'DONNELL: Those were just Canadian Government Railways, and they are the ones which were turned over by way of entrustment to the---

THE CHAIRMAN: They were entrusted for management and operation.

MR O'DONNELL: That is right, by Order in Council P.C.115, a copy of which I believe has already been pro-

vided to the Commission.

THE CHAIRMAN: Did they remain the property of the Government?

MR O'DONNELL: That is my understanding.

THE CHAIRMAN: They did not become the property of the company?

MR O'DONNELL: No.

The second group:

2. Grand Trunk Railway System

This system consisted of the Grand Trunk Railway Company of Canada and companies directly controlled by this Company either by 100% stock ownership or majority stock ownership (listed in Chapter 13, Statutes of 1920). There were also certain other companies controlled by lease; there were other companies controlled by subsidiary companies. Included in the latter were certain subsidiaries controlled by the Grand Trunk Pacific Railway Company by ownership of 100% of the stock. Among the companies directly controlled by the Grand Trunk Railway Company of Canada were:

Central Vermont Railway Company

Grand Trunk Pacific Railway Company

Grand Trunk Western Railway Company

International Bridge Company

Montreal & Southern Counties Railway Company

St. Clair Tunnel Company

The Rail & River Coal Company

3. Canadian Northern Railway System

This system consisted of the Canadian Northern Railway Company and certain constituent and subsidiary companies (listed in Chapter 13, Statutes of 1919). Among these were:

The Canadian Northern Ontario Railway Company
The Canadian Northern Alberta Railway Company
Mount Royal Tunnel and Terminal Company, Limited
Duluth, Winnipeg and Pacific Railway Company
The Halifax and South Western Railway Company
The Niagara, St. Catharines & Toronto Railway Company
The Canadian Northern Telegraph Company
The Canadian Northern Rolling Stock, Limited

4. Grand Trunk Pacific Railway System

This system consisted of the Grand Trunk Pacific Railway Company and wholly-owned subsidiaries controlled by ownership of 100% of stock. Among these were:

Grand Trunk Pacific Branch Lines Company
The Grand Trunk Pacific Saskatchewan Railway Company
Grand Trunk Pacific Telegraph Company
Grand Trunk Pacific Coast Steamship Co. Ltd.
Grand Trunk Pacific Terminal Elevator Co. Ltd.
Grand Trunk Pacific Development Company Ltd.

Now, those various companies that I have read the Commission will find set out in the schedule to the Act which I mentioned above -- that is, in the Revised Statutes of Canada they will be found to be chapter 172, and the schedule is at the back of the Act, that is, the Canadian National Railway Company Act.

COMMISSIONER INNIS: What are the advantages of entrustment to the railway, Mr. O'Donnell?

MR O'DONNELL: To the railway as such?

COMMISSIONER INNIS: Or to the Government.

MR O'DONNELL: I assume that the Government finds an administrator, an operator for the lines which it owns, and turns them over to that agent for the purpose of management and operation for the account of the Government, either for its profit or for its loss, as the case may be.

COMMISSIONER INNIS: That is advantageous to the railway, then.

MR O'DONNELL: Well, it certainly keeps the railway officers occupied trying to run those companies. I have not any more complete answer at the moment with respect to that, but I would assume that it is a convenient way for the Government to handle the management and operation of the various roads which it owns and which it feels must be operated in the national interest. It turns them over to this creature of the statute, the corporation, Canadian National Railway Company, for the purpose of management and operation.

COMMISSIONER INNIS: The same terms were followed in the case of the Newfoundland Railway?

MR O'DONNELL: Yes. Well, the Order in Council in the case of the Newfoundland Railway is in, and I think the conditions there again are the same -- and the Temiscouata Railway also, which has just been taken over.

THE CHAIRMAN: Just going back for a moment, so that it may be carried on in our minds, there are certain of these lines among the numerous ones mentioned there that the company does own in its own right?

MR O'DONNELL: Yes.

THE CHAIRMAN: What are they? Can you make a ready reference to them?

MR O'DONNELL: Well, yes, and I intend through Mr. Fairweather to demonstrate it a little more clearly, because, as your lordship remembers, you referred I think to the Grand Trunk as the core, possibly, and Mr. Fairweather will elaborate on that aspect of the matter.

I intend now, with the permission of the Commission, to continue with the testimony of Mr. Fairweather. The Commission will remember that Mr. Fairweather commenced his

testimony at the hearing on March 24, 1950, and his evidence may be found in volume 103, commencing at page 19106 and continuing to the end of that volume.

S. W. FAIRWEATHER, Recalled

EXAMINED BY MR O'DONNELL:

Q. Mr. Fairweather, you will remember that we were reviewing certain particulars of the statement made by the President of Canadian National Railway Company, Mr. Donald Gordon, when he appeared before the Commission, and that at the time of adjournment you were commenting to the Commission upon that portion of the statement which appears on page 13 under the heading "Effect of Development Lines" on the Canadian National. I understand that you intended to prepare a list of the development branch lines or development lines which the Canadian National Railway Company have constructed since 1923, and if you have that statement with you I would ask you to produce it as Exhibit 269, and to make any comments which you may consider pertinent to it.

THE CHAIRMAN: What is the title of it?

MR O'DONNELL: I think Mr. Fairweather has prepared the statement in a way that is even more satisfactory than the way that I had suggested to him, because he acted, I think, in accordance with your lordship's suggestion and has prepared a map with red lines and blue lines distinguishing those parts of the system which are development lines from the other portions of it, and on the face of the map, which will now be produced as Exhibit 269, I think the Commission will find the list of the lines and the dates when they were opened for operation.

So possibly, Mr. Fairweather, you would be good enough just to explain it.

For the purpose of the record, my lord: Exhibit 269 is entitled "Map of Canadian National Railways indicating Branch Lines constructed since 1923, showing Year opened for operation."

---EXHIBIT 269: Map of Canadian National Railways indicating Branch Lines constructed since 1923, showing Year opened for operation.

THE CHAIRMAN: Do I understand that this map shows only the branch lines? Is that what you said?

MR O'DONNELL: Yes, my lord.

Q. Mr. Fairweather, will you explain to his lordship and the members of the Commission what the map indicates?

A. Well, I thought it would be most informative to the Commission on this subject if, in addition to furnishing a list of the development branch lines constructed since 1923, the location of these lines were shown on a map, from which their relationship to the system could be seen, and also the distribution of them throughout the various parts of the country. On the map in question these branch lines are shown in red, and each line is given a number. That number will give you a reference to the list which appears on the map. The list shows the common name by which the branch line is known, and it gives the year the line was opened for operation. In cases where the whole of the authority to construct the line was not exercised or where construction was stopped, the line is shown dotted. The full red line represents branch lines which were built since 1923 and which are now in use.

COMMISSIONER INNIS: Q. Those lines that you have referred to as being partially operated, are there only two of those?

A. There is the Sunny Bree-Guysborough.

MR O'DONNELL: That is No.1 on the list.

THE WITNESS: No. 1 on the list; and No. 38 on the

list, St. Walburg-Bonnyville. Then there is another one incomplete, Bulwark -Airways, Alberta, No. 42.

Q. And your unbroken red line represents the branch lines now in operation, and the dotted red line represents those which have not been fully completed for operation?

COMMISSIONER INNIS: Q. Just what does that mean? Does that mean a certain amount of money has been sunk in those lines and they are thrown up, or---

A. Yes, that is a generalization. What happened was, in these incomplete lines, that the onset of the great depression interrupted the construction of certain of these branch lines. Now---

THE CHAIRMAN: Q. Construction has not been resumed since.?

A. Construction has not been resumed.

COMMISSIONER INNIS: Q. How much money would have been spent on the line from Sunny Brae to Guysborough?

A. What actually was spent?

Q. Yes.

A. Well, I can give you that information, sir.

Q. Is that operated at all? Is that simply a dead loss?

A. It is operated for a few miles, but it is only, I think, a matter of perhaps eight or ten miles. The Sunny Brae-Guysborough line, I find that they spent \$3,532,000 on it, and I think I am correct in saying it is about eight or ten miles of it that is in operation.

Q. What about this other line---

THE CHAIRMAN: Q. Has the Government any intentions about that Guysborough line?

A. Well, I could not speak for the Government's intention, sir.

Q. Pardon me, I mean the company.

A. The company has no intention of constructing that line.

COMMISSIONER INNIS: Q. How much has been spent on the St. Walburg-Bonnyville?

A. What number is that, sir?

MR O'DONNELL: That is 38.

THE WITNESS: \$2,007,000.

COMMISSIONER INNIS: Q. And the incomplete one, Bulwark-Airways?

MR O'DONNELL: That is No. 42.

THE WITNESS: \$415,000.

Q. And nothing more is planned with regard to all those items?

A. Not at the moment, sir. A good many of them, representations have been made that they should be completed, but so far the management of the Canadian National has not seen its way clear to recommend that that be done.

MR O'DONNELL: Q. Is there anything else that the Commission would like, or have you any other comments to make on that exhibit, Mr. Fairweather, before we turn to something else -- Exhibit 269?

A. No, I have no other comments.

Q. Now, I believe you told the Commission, Mr. Fairweather, that a development line, even when clearly justifiable in the national interest, will rarely if ever produce earnings in the early years of operation sufficient to pay added operating expenses and interest charges, and that it would seem desirable therefore, if a balanced capital structure is to be maintained, that only a portion of the cost should be financed with borrowed funds. Now, in this connection, would you care to comment upon the practice which continued up to World War I of granting subsidies for the constructions of railways?

(Page 20043 follows)

A. Well, of course, prior to world war I there was a subsidy arrangement, and from time to time Parliament passed a subsidy act with regard to branch line extensions.

The general practice was to give a subsidy of \$3,200 per mile on the first \$15,000 of the cost and a maximum of an additional \$3,200 on the amount over \$15,000, with the provision that that extra subsidy should not amount to more than 50% of the excess cost over \$15,000. By that machinery it was possible to obtain a subsidy up to as much as 30% of the cost of a branch line, and undoubtedly in the period of railway development it had a decided influence on the extension of branch lines.

The extension of branch lines or the construction of a development branch line involves an initial expenditure of capital before any traffic can be expected, and that capital is quite substantial in amount. At the present time I do not think on the average you can build a line of development railway for much less than \$80,000 a mile, and if the country is difficult you would find yourself possibly paying \$115,000 per mile.

COMMISSIONER INNIS: Q. Is that generally true for both the C.P.R. and the C.N.R?

A. I can only say that I am speaking of Canadian National estimates, but I should not think there would be too great a difference. The practice of the Canadian National when considering such lines is to estimate the cost of the line, and then to estimate, as far as we can, the amount of traffic that might be expected to develop based upon the natural resources of the area served. Those natural resources might be agricultural, they might be products of the forests, they might be fishing or mining.

Then having established what we think is the fair potential traffic of the line, we try to judge how long a

period of time it will take before that development will be realized. From this information we attempt to forecast, for the information of our board of directors, the probable income result of the extension of the branch line. In making up such an income account we credit to the branch line all of the rail revenues which we anticipate no matter whether those rail revenues might be said to apply only to the branch or whether it applies to the balance of the system, that is, we take into account the feeder value of the line.

On the expense side we take into account the operating expenses of the branch line including maintenance, train operation and station service, and then we estimate the cost of hauling interchange traffic on the balance of the system using for such purpose an out of pocket cost basis. We then obtain in that manner the amount of money which we expect will be available to service the capital invested in the additional branch line. We do not ordinarily recommend a branch line unless at full development there is a credit balance, that is, at full development the branch line should pay interest upon the cost of construction.

THE CHAIRMAN: Q. When you say "we" you mean your--

A. My department. Then taking the future into account we have this, an initial period in which there is almost no traffic and you still have the operating expenses for maintenance of minimum operation on the branch line, and you have under those conditions an income loss invariably. Then in five or ten years as development is anticipated that income loss will be diminished, but in the meantime the interest charges on the line will be appearing as additional deficits.

It is . . . extremely difficult under any set

of conditions that I have examined to extend a branch line with the assurance that it will be profitable to the parent system, even when you take the feeder value into account, for some considerable period of time. In the case of a branch line to serve a mine that period is shorter. - the period of deficit operation is likely to be shorter than it would be if you are serving a general development area where you are depending upon the agricultural and forest economy for your results.

I mentioned previously that unless some such medium as is suggested with regard to relieving the railway company of a part of the interest burden on its branch lines was worked out, and if we assume that further development lines are going to be necessary in Canada, you will create a situation in which the capital structure of the Canadian National would once more get out of balance. From the standpoint of preserving a reasonable balance between interest bearing capital and equity capital I think this provision that 40% of the cost of a branch line be provided as equity capital is the minimum.

MR. O'DONNELL: Q. That is the submission set out at page 15 of the president's statement, paragraph No. 3?

A. Yes. I note that United States roads have 45% of their capital as equity, and if the Canadian National Railways are to expand it seems to me logical that at least 40% of that expansion capital should be furnished on an interest free basis if your objective is to preserve some sort of reasonable stability and comparability.

THE CHAIRMAN: Q. Equity capital held by the government.

A. Equity capital held by the government.

Q. And in the United States the equity capital is held by the public? Is that what you mean?

A. Equity capital in the United States would mean held by the shareholders of the railway, and equity capital in our case means the shareholders of the railway and that means the government.

COMMISSIONER ANGUS: Q. Is equity capital held by the shareholders of the railway really interest free in the same sense that equity capital held by the government is interest free?

A. Well, I don't know that there is any real difference. As I see it, the distinction is simply this, that with regard to a fixed interest bearing obligation that is paid in any event. In connection with equity investment you get whatever your enterprise will yield after you have paid your charges. So that there is really no difference as I see it. The government in our case is the shareholder, and in the United States the shareholders are individuals but the economics is exactly the same.

THE CHAIRMAN: Q. When you use the word "interest" do you mean in dividends?

A. Pardon?

Q. Do you mean dividends when you say "interest"?

A. Interest --

Q. On the equity capital?

A. I do not think I said interest on equity capital.

Q. Somebody used the word.

A. I do not think I did. I would treat it as a return on equity capital.

MR. O'DONNELL: Q. And that is ordinarily done by way of a dividend?

A. Ordinarily in a private enterprise it would be a dividend, and in the case of the Canadian National it would

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be surplus earnings of the Canadian National.

COMMISSIONER ANGUS: Q. Isn't there this difference? You said if the Canadian National builds a branch line 40% of the cost it might be will be money on which you had to pay interest, raise your fixed charges, and that the 60% should be money on which you did not have to pay interest. Have you compared that with privately owned railways considering the construction of a branch line? Doesn't a privately owned railway have to say that 40% would consist of fixed charges on which we pay a low rate of interest and 60% of equity capital on which we are obligated to pay a higher rate of interest, not nothing at all?

A. In the first place, sir, I think that so far as the Canadian National is concerned the percentages of 60 and 40 are just the reverse to the way you have put them, that is, we maintain 40% of the capital should not be fixed interest bearing and that 60% should be.

Q. Yes.

A. But with regard to the balance of your statement I can only say that I cannot understand equity capital as being entitled to any more than it can earn. That is my conception of it. It takes whatever is left. It takes managerial risks, and you cannot, in my judgment at least, set any definite figure to it. If you are thinking of inducing capital to come into equity investment they have to see a reasonable opportunity of profit, but I don't think that it can be stated to be any figure.

Q. If just and reasonable rates are being computed in respect of a private railway so as to give it a return on its equity capital, has that any counterpart in the case of a railway with a financial structure like that of the Canadian National?

A. Well, as I see it, it all revolves around this. The Canadian National Railways has a horribly unbalanced capital structure, and that is, in the judgment of the management, creating a bad managerial atmosphere. It is the opinion of the management that that situation should be remedied. Now, if it is remedied it must necessarily mean that the Canadian National Railways should only be asked or expected to pay as fixed interest upon investment such an amount as might be reasonable in the light of all of the circumstances. Then I say that if you are dealing with an institution such as the Canadian National that has no access to equity capital except through the government, and it has in the past been forced to borrow and pay interest upon every bit of its expansion, you would have a pyramiding capital structure of the Canadian National even if you adjusted it now to a reasonable basis, and if in the future all of the capital needed for expansion had to be borrowed you would have ^{it} once again climbing into a position of unbalance where you would have more fixed interest bearing burden than the general run of the railway industry.

I think that is the sum and substance of the matter. It does not mean that 40% which is to be provided interest free should not be expected to earn a return, and I may say this, that in analyzing any extensions of the Canadian National the full cost would be taken into account, and the line would be tested by its ability to earn a return on all of the investment. That, I think, clears up the point.

MR. O'DONNELL: Q. Although that return might not, as I think you said before when you testified, be expected to be available before some years, even fifteen odd years?

A. No, that is quite true. You cannot do it. We were

approached by an industry, and by the province of Quebec, to build a branch line down in the Abitibi country. It is the first branch line built after the war. We made a very thorough study of that situation. We satisfied ourselves, after such an investigation, that there was a reasonable prospect of that line . ultimately working into a position where it would carry itself.

Q. That is the Barraute line?

A. That is the Barraute line.

THE CHAIRMAN: Q. That is one of the lines shown --

A. It is one of the lines shown on this map and I can give you the number of it.

MR. O'DONNELL: Number 8.

THE WITNESS: That would be number 8.

MR. O'DONNELL: On Exhibit 269.

THE WITNESS: That line will not start to show a net return to the Canadian National for a matter of ten years, but I am happy to say that the development programme which we outlined, and upon which we based our decision, has been lived up to and actually exceeded in the first year of its operation. We expected that that line would produce 40,000 cords of pulpwood in its first year of operation, and actually I think it produced somewhere around 43,000 cords. We also expected settlers to go in on the land in certain numbers, and that development is taking place.

COMMISSIONER INNIS: Q. How do you square all this caution with the expenditure of moneys on these lines which have been unfinished?

A. Well, I am naturally speaking of the conditions at the present time. I think if one goes back and examines these lines that are now incomplete one will find that they were part and parcel of a boom economy, and I think

we learned something from that. Those lines were projected in the peak of the 1928 boom.

COMMISSIONER ANGUS: Q. What rate of return do you use for your calculations?

A. Well, it is our practice to use about 3% as the cost of money to us.

Q. 3% on the 100% of the cost of the branch line?

A. That is about our formula. Sometimes we go a little higher. It depends upon the circumstances but 3% would be the current rate.

COMMISSIONER INNIS: Q. Do you think you would be wise enough to resist any tendencies to boom in the future?

A. I think prudent management has to consider all of the circumstances, and certainly if management considers it is in a boom economy I think that it would be prudent to take that into account. I certainly do.

Q. It would be pretty difficult to get prudence under those circumstances?

A. Well, I don't know. At least you can say this, that I think the management of the Canadian National Railways since, let us say, depression times will stand the challenge of anybody as to prudence. We may have slipped over during the boom period but I certainly think the service rendered by the Canadian National since that time has been on a most prudent basis, and I cannot see any evidence that at the present time we are being improvident about expansion. I told you about the Barraute line. It was certainly no improvident expansion because it was keyed into a very carefully planned programme of development, partly the province of Quebec and partly the Howard Smith paper interests. They had these limits in northern Quebec which were inaccessible and they wanted to expand their plant. They hadn't pulpwood; they couldn't get it,

and they came to us and said, "Will you build a branch line to make that pulpwood accessible"? The province said, "We want to settle this north country; we have settled all of the land which is now available within reasonable range of railways; will you extend the line"? We sat down with them and figured it out and eventually we built the line, and I think it was a prudent thing to do.

(Page 20055 follows)

THE CHAIRMAN: Q What is the length of it?

A. Forty miles. The authority that we obtained was to extend it to the crossing of the Bell River, a distance of 70 miles, I think it was; I am told it is about 80 miles; and we did not use the full authority because we did not think it prudent to go there.

MR. O'DONNELL: Q. That authority is found in the Statute?

A. The authority is in the Statute, but we did not use the full authority because in our judgment it was not prudent as yet to go there.

COMMISSIONER INNIS: That is the line about which Mr. LaMontagne appeared before us?

MR. O'DONNELL: In that general area, I think it is.

THE WITNESS: The people in that area are pressing for that line to be extended. Personally, I feel that the time will come when it will be extended.

MR. O'DONNELL: Q. He is the gentleman who said that if it was the C.P.R. that owned it, he would not expect them to do it, but inasmuch as the Canadian National Railways own it, it was fair game and we should go ahead with the project.

A. We do not listen to arguments like that.

COMMISSIONER INNIS: Q. You must have listened to something like that when you have these lines which have not been completed?

A. I think those lines were built under boom conditions and I would think they taught everyone a lesson. I do not think it was only the Canadian National Railway Company that fell into the error of building lines

that subsequently have not proved to be quite what they should be.

MR. O'DONNELL: Q. On that list given in Exhibit 269, there are forty-nine lines listed, and of the forty-nine I think there are only three not completed.

A. There are some more than that.

Q. There are five altogether that have not been completed?

A. Yes.

Q. And the dates are set out there?

A. Yes.

Q. As you say, most of those are in the boom days of 1926, 1927, 1928, 1929 and so on and very few of them are in the later years?

A. That is right.

Q. This Barraute Line is the only post-war venture, is it not?

A. The Barraute Line is the first branch line built in Canada after the war.

COMMISSIONER ANGUS: When you say 3%, do you mean 3% as from the date of construction or do you mean 3% on 60% from the beginning, and rising slowly to 3% on the whole cost?

A. No. It means 3% on the cost of the whole line at the date of completion, including, I may say, the interest during the construction period which is capitalized.

Q. Do you think that 3% is a figure that is comparable with the $6\frac{1}{2}\%$ that the Canadian Pacific considers it should earn on its own investment?

A. Certainly on the face of it it is not comparable, but the 3% is the basis. That is the floor that we put under the consideration of the branch lines extension. Naturally we want to be assured that within a reasonable

period of time we will at least get our fixed charges back. We do not think we would be satisfied with that. We expect that after that development has been completed, this line will add to the System revenues and System net on a higher proportion and that would become applicable to the equity capital of which I spoke.

MR. O'DONNELL: For the convenience of the Commission, I might indicate that the prior discussion which we had with Mr. Fairweather concerning the effect of development lines will be found in Volume 103 beginning at page 19163. It is now several weeks since we discussed the matter and I thought I might mention the reference at this point.

There is one other thing, my lord. Your lordship asked me - -

MR. SINCLAIR: What page was that, Mr. O'Donnell?

MR. O'DONNELL: Page 19163. Your lordship asked me , as you will remember, or rather you said you would expect to hear further from me as to the rider which Mr. Gordon had put on that paragraph No. 3 on page 15 of this statement, which is limited, as is said there to future development lines. He is referring to those lines which in the course of prudent administration a commercial railway would undertake in keeping abreast of national development and in anticipating and creating a demand for its service. It is such lines that he submitted should be financed to the extent of not more than 60% by interest-bearing securities. In respect of acquired railways or development lines constructed by the Government and later entrusted to the Canadian National Railways for management and operation under Section 19 of the Canadian National Railways Act, no submission is made to the

Commission. The law is there, and under the law railways which the government may see fit to construct may be turned over to the Canadian National for administration and operation. We have no representation or submission to make in connection with that.

THE CHAIRMAN: You simply tell us what your intentions are?

MR. O'DONNELL: Yes, my lord; that is the object, with respect to these future development lines which they indicated are of the type referred to.

THE CHAIRMAN: Even in cases where the forty per cent of the capital at least is to be provided by way of equity stock, you do not find yourself inclined to do any construction unless in your own view it is proper to do so?

MR. O'DONNELL: That is right. If, on the other hand, the government sees fit to build a line, of its own initiative, to meet the views of the people who are asking for the service and chooses to turn it over to the Canadian National for operation and management, we have no objection to that. That is done under the entrustment section of the Act, and that is the reason for which the Canadian National Railway Company, in part at least, was originally incorporated.

COMMISSIONER INNIS: You have no objection, even though it might be embarrassing to you?

MR. O'DONNELL: We should like to have it on equitable terms but, as I say, I think under the Act the government has the power, as the matter stands now, to force us to operate and manage these lines if they are entrusted to us. But where we have any judgment in the matter ---

THE CHAIRMAN: In so far as building is concerned, if you are intending to build, you have to apply to the government for authority, as I read the Act.

MR. O'DONNELL: We have to apply to Parliament.

THE CHAIRMAN: Yes; you have to apply to Parliament for authority. You say that you want to leave the Statute that way?

MR. O DONNELL: Yes.

THE CHAIRMAN: You simply tell us that you do not intend to be led on to construction by suggestions made from any quarter? You intend to remain perfectly free in that respect even if forty percent of equity capital is available to you.

MR. O'DONNELL: It might not be construction that we, in the exercise of our good business judgment, would think to be a fit and proper undertaking.

COMMISSIONER INNIS: If the government persist in undertaking it, you are quite willing for them to do so?

MR. O'DONNELL: That is something we cannot prevent or help. If the government, in the exercise of its statutory power under Section 19 of the Canadian National Railways Act, chooses to foist one of these lines on to us, then there we are. As has been indicated by my friend, we would of course endeavour to obtain the most equitable terms possible; but in the final analysis we are bound by the statute.

Q. Mr.Fairweather, there is just one thing I omitted to draw to your attention concerning the Newfoundland Railway and Steamship Service when last you were here. At pages 19158 and 19159 in Volume 103, you gave evidence concerning this matter, and I should have asked you to comment on the last paragraph on page 12 of Mr. Gordon's statement which reads as follows:

"It is anticipated that the operations of the Newfoundland Railway and Steamship Services will burden the System income account to the extent of

"\$4,000,000 yearly. Expressed in terms of negative capital this amounts to \$134,000,000. Further, substantial amounts of capital will also be required from time to time to improve the property."

Will you just comment briefly upon that last sentence which I omitted to draw to your attention when you were here before?

A. In my previous evidence I gave in very sketchy outline the nature of the operation conducted by the Canadian National in Newfoundland, both railway and steamships. I pointed out that unfortunately the out-of-pocket cost of service exceeds the revenues that can be obtained, so that even if you do put additional capital into the property there is no hope of ever recovering a return on that capital. The Newfoundland Railway is in need of very considerable equipment. It needs terminals.

THE CHAIRMAN: Q. It needs what?

A. Terminals. That is a technical term for the place where the road movement meets the operating points where yard operations have to be conducted; that is, railway operations, broadly speaking, consist of road movements and yard movements, and the terminals are really just another name for railway yards. The railway yards or terminals in Newfoundland are such that we shall have to spend a lot of capital. Then we shall have to spend a lot of capital on ballasting; and I should say that over the next ten years we shall have to renew all the rail in Newfoundland. On the steamship side, we shall have to supply additional ships. The reason for that is that while Newfoundland was operating under Commission government, naturally they had their own regulation with regard to shipping. The Canadian regulations are much more severe.

It simply means that to handle the same amount of traffic we have to have more ships. Altogether, the amount of capital that will be needed over the next ten years in Newfoundland is very substantial. I have not made any exact estimate of it, but it is quite substantial.

Then, of course, we must remember that this is a narrow gauge railway, and everything we buy for it is special, so we have to pay a higher price for everything we buy for use there. I think that should clear up the point.

MR. O'DONNELL: That is satisfactory, as far as I am concerned .

COMMISSIONER ANGUS: Q. How do you expect to get that capital? Is it to be equity capital, or what?

A. In this case, under our submission, if we get relief to the extent contemplated, it would be the intention to include these capital amounts in the budget of the Canadian National and have them authorized by Parliament just as for any other part of the system. That is, we realize that here is a situation that is very special. We estimate that there is negative capital that can be clearly demonstrated to the tune of \$134,000,000, and that while some claim might be made to find the capital for these things in Newfoundland in a special category, nevertheless no such submission is being made. It would be part and parcel of the general capital budget of the Canadian National submitted to Parliament and approved by Parliament.

Q. And that means that you would expect them to provide you with money for this capital expenditure?

A. Yes. We would go to the government to get the money, either by government vote or by authority to float issues, one or the other.

Q. If you got it by government vote, would you

expect to be giving the government equity shares in exchange?

A. No.

Q. Or just get it as a special grant?

A. In that case, we would borrow the money against a note of indebtedness. If we borrowed it from the government, we ^{would} give the government a note. If we borrowed it from the public under government guarantee, we would give the public bonds.

Q. Would you expect that to increase your fixed charges, on this account?

A. Yes, certainly. It is one of the things we contemplated, and it is because we see that that we are asking the relief.

THE CHAIRMAN: We will take a few minutes recess.

-- After Recess:

COMMISSIONER ANGUS: Q. Mr.Fairweather, if the fixed charges of the Canadian National are reduced, so that it is a manageable burden, is it really sound to increase them above that point without an increase in earning power?

A. Certainly not; but in a huge system you necessarily have to have consideration to the fact that there will be some unremunerative capital that you will have to take on, and you hope that there will be enough remunerative capital that will be sufficiently remunerative to bear the burden of this unremunerative capital. It is a part of the managerial game, and that has been taken into account in this submission.

Q. I am getting a little bit confused in this way. There seems to be equity capital on which you expect to earn no return, and then equity capital in the case of these branch lines on which you expect to earn three per cent, and then these fixed charges, some of which are

expected to pay their way as in the case of the branch lines, and others that are expected to bring in nothing, as in the case of Newfoundland. Ought one to try to speak in terms of a capital structure that would take account of these differences?

A. I think that is the submission, sir, that it does. The exact mechanism of it is perhaps debatable, but the purpose of the adjustment is to get a fixed capital burden of interest-bearing securities which is, as you say, manageable. Then you take such precautions with regard to the larger items of capital expenditure which would result from expansion of the property, to see that it did not become unmanageable from that source. Then, so far as the internal conditions and operation of the property, considering a static condition of the physical size, and expanding in traffic with the growth of the country, the judgment is that if the relief asked for in this brief is given, on the average the Canadian National would be able to be free from a deficit position and to have a moderate amount left over which could be plowed back into the property and prevent the pyramiding of unprofitable capital. That, broadly speaking, I think is the purpose of the submission.

MR. O'DONNELL: And the Canadian National now has, as a matter of fact, all the principal properties that were at one time in the category of being bothersome ones?

A. Oh, yes.

COMMISSIONER ANGUS: Were what?

MR. O'DONNELL: That might be considered as non-remunerative and bothersome from a managerial point of view.

Q. And the submission is directed particularly to those new lines which may be built in the future?

A. Yes. There is a guard put there, which is obviously a prudent guard, to see that the capital structure would

not, by expansion, get out of hand again. Now of course that guard has to be supplemented by prudent management, and that prudent management is assumed.

THE CHAIRMAN: Q. The Statute should then be left as it is and left in the way it is now worded. It seems to me that the Statute provides for that. It says that you may^{apply}/for permission to build new lines or acquire new lines.

A. The only thing is this. We feel that at present when we apply for permission to build a new line we are expected to take in our funded debt an amount equal to the cost of the construction of the line. We do not want to do that. We only want to take in 60% of it.

(Page 20070 follows)

Q. Yes, I know, there is that very important difference, but I was talking now about the incentive to build.

A. Oh, quite.

Q. You want to have that entirely?

A. Oh, quite.

Q. The statute to be carried out?

A. Quite.

COMMISSIONER ANGUS: Q. The question I was really thinking of was this: Is it sufficient to have a distinction between fixed charges or capital that results in fixed charges and equity capital, or should one perhaps try to think of two classes of equity capital -- A shares on which you expect to earn a return, and B shares on which the prospect of earning a return is very remote?

A. Well, as I said, the exact mechanism that you use I think is a matter that might be considered, but for my purpose I maintain that the submission as made is a workable one; it is a workable submission which if put into operation should, so far as anyone can prudently look at the future, result in a balanced capital structure for the Canadian National at a level that it could reasonably bear, and would promote efficient operation of the property, which is the sole justification for doing it, as I see it.

Q. When you say it is a workable system, do you mean that it is workable in relation to the Canadian National taken by itself, or that it is also workable in respect of Canadian transportation policy, which includes both railways?

A. Oh, I would say the latter, sir.

Q. And workable in respect of the fixing of rates and so on?

A. Well, of course, the fixing of rates and matters of that kind is a matter which is under the jurisdiction of

the Board of Transport Commissioners. Now, the Board of Transport Commissioners with this set-up of the Canadian National, in which every dollar that is invested in the Canadian National is shown, is going to be in full possession of all the facts and can evaluate the situation on such level as they consider reasonable and just. They will have all the facts in front of them. What the Canadian National desires is an adjustment of its capital structure to a level that it can improve its managerial efficiency.

Q. What I meant was perhaps this, that it is no doubt quite adequate for the purposes of the Board of Transport Commissioners if it has all the facts and it can use them in this form, but is the form a little too complicated for the general public, shall we say, which is to some extent trying to understand what the Board is doing? Has this system got sufficient intelligibility at the particular level---

A. Well, I think it has. I think actually it is a very simple and almost a brilliant solution of what has been a chronic problem. Now, in a previous Royal Commission I had an opportunity of discussing this very matter, and on that occasion the problem was admitted. It is referred to in their report.

MR O'DONNELL: That is the Duff Report.

THE WITNESS: But when I told them the size of the adjustment that was necessary to put the Canadian National System on a comparable basis with a commercial concern they said, "Oh, my goodness, we will leave this to someone else," and the adjustment which is now being proposed is about of the same scope as I then suggested to the Duff Commission.

THE CHAIRMAN: Q. Are we the someone else?

A. I would trust, sir, that the present Commission will deal with the matter definitively and give us a chance to show what we can do with improved managerial efficiency resulting from a realistic capital structure. It is a challenge to us. At the present time we have in normal times no target except how big our deficit is going to be, and that is bad for the organization.

COMMISSIONER ANGUS: Q. Do you think that this system would make it possible for you to say how big your reasonable net income ought to be? Do you think it really gives you a defined target?

A. I did not quite get that, sir.

Q. Do you think that this proposed capital structure would make it possible for you to say, not what you have said hitherto, "How big should our deficit be?" but make it possible for you to say, "How big ought our income to be?"

A. I think that this adjustment is not going to make any feather bed for the Canadian National Railways. I am convinced that over the future, with the problems that are facing the railway industry and the Canadian National, these adjustments, together with such traffic as we will be able to handle, are not going to produce any more than the minimum required to perpetuate a reasonable capital structure. That is my opinion. There is no great amount of leeway over and above (a) the meeting on the average of your fixed charges and (b) protection against the pyramiding of your capital structure.

COMMISSIONER INNIS: Q. When you said "almost brilliant" did you mean that you had some reservation, or was it just modesty?

A. Just modesty, expressed on behalf of the Canadian National.

MR O'DONNELL: Q. The situation is somewhat different, is it not, Mr. Fairweather, since the Duff Commission, in that the Government today has in its hands this \$760 million of interest-bearing obligations?

A. Oh, that makes the mechanism of the thing easier, I quite admit.

Q. And as to the balance of it the difficulty which previously existed of handling the debt which was in the hands of the public is solved on a reasonable compromise basis by this proposal?

A. It is easier to do it.

Q. Now, with respect to what Dr. Angus mentioned there as to the possibility of handling the situation through the use of A and B shares, that proposal or a proposal of that kind I understand was considered and it was not deemed workable by reason of the difficulty which existed with respect to allocating any particular line or part of a line to either the A category or the B category or whatever other categories might be used?

A. Well, certainly just the two divisions, interest-bearing on the one hand and equity capital on the other, is the acme of simplicity, and it has that advantage. The idea of having various gradations was considered, and it was rejected because of the complications that appeared in it. The measuring stick between the fixed interest-bearing debt and other debt is relatively simple to work out, but the other one, to introduce gradations, involves refinements of analysis that personally I do not think worth while; I do not think you get enough for them.

COMMISSIONER INNIS: Q. Have you considered the effects on the Canadian Pacific Railway?

A. Well, all I can say with regard to that is this, that this is a proposal for the Canadian National Railways.

I have stated that it is no feather-bed proposal at all. It will, in my judgment -- and also it is the judgment of Mr. Gordon and his Board of Directors, that this is the minimum that is required if you are to achieve these two objectives -- (a), that on the average we should be, with prudent management, free from deficit financing, and (b) that we can maintain a reasonable stability of the capital structure of the Canadian National. Now, in arriving at that conclusion the whole field of managerial discretion was reviewed so far as we had confidence to do it, and we honestly feel that this is a minimum. Now, as to the effect on the Canadian Pacific, the only thing I can say is this -- and this is my personal judgment -- that under any conditions under which the Canadian National would be operating here, the Canadian Pacific with its higher traffic density is placed in a more favourable position than the Canadian National, by reason of its higher traffic density.

THE CHAIRMAN: Q. What did you say at the last of your answer?

A. By reason of its higher traffic density. That higher traffic density in railway operation is the major controlling factor.

COMMISSIONER INNIS: Q. Would that lead to charges against the Canadian Pacific that it was being feather-bedded?

A. Would you mind repeating that?

Q. Would that lead to charges against the Canadian Pacific that it was getting a feather bed, even if the Canadian National was not?

A. I do not see that that follows at all. Our problem is a much more severe one than the Canadian Pacific. Now---

Q. I am not considering your problem; I am considering the problem of the Canadian Pacific in relation to the pro-

posal which you put forward.

A. Well, I do not see that it would damage the Canadian Pacific, personally.

Q. No; you say it would improve their position?

A. No, I did not say that the adjustment of the Canadian National would improve the Canadian Pacific position. I am sorry if I conveyed that impression. What I said was that under traffic conditions that would produce with this readjustment of the capital structure of the Canadian National the objectives that we state, that the Canadian Pacific would not be harmed. That is what I said.

COMMISSIONER ANGUS: Q. You speak of paying your fixed charges on average. Do you think that makes them comparable with the fixed charges of a commercial railway? I mean, does it expect to meet its fixed charges on average or does it expect to meet them in a pretty bad year?

A. Well, that, I think, sir, just illustrates how really conservative this adjustment of the capital structure of the Canadian National is.

Q. It may suggest that it is too conservative?

A. Well, it may be, you see, it may be, but actually it was considered that for a road such as the Canadian National, with its financial history and its low traffic density and the extreme barometrical nature of its net income, none of the capital should be interest-bearing, and that is stated in the brief; but, in view of the possible trends in the future, where we look to an increase in population in Canada and we look to increasing traffic density of the Canadian National, the management considered that they might prudently leave the \$283 million still as fixed interest-bearing capital; but in doing it they did not overlook the possibility that, with the extremely barometrical nature of our financial returns, there might

be years in which we could not even pay those fixed charges.

Q. As I understand the Canadian Pacific argument, it is more or less this, that the fixed charges that you propose are fixed at a level that makes them a little ambiguous, it makes them look as if they were the target income, the proper income for the railway, and that if they were considerably lower that danger would not arise, that you then would expect the fixed charges to be met easily and expect some income over and above that that would be expressed in terms of some other type of capital, and that it would remove the danger of the desirable income being thought of by the public as merely these fixed charges, no more and no less. Now, have they perhaps been fixed -- this, after all, is the question before us -- at a dangerous level, not dangerous to the Canadian National Railways but dangerous to the Canadian transportation policy, in being a little misleading? If they were higher, then that would be an objective that might afford protection to the Canadian Pacific; if they were lower, then there would obviously be other earnings applied on equity capital, applied on income bonds, whatever it might be. Did that point receive consideration?

A. Oh, yes, it did, and for my part I think that good and prudent management consists in giving the Canadian National Railway a target to shoot at, that they should be striving to hit, and I think that that target should be set as high as it can be reasonably set; that is, I am looking at this thing from the standpoint of stimulating managerial efficiency. We have been operating for years and years and years in a hopeless atmosphere of deficit operations except during the extreme peak of the 1928 boom and also the most exceptional circumstances of the war. Now,

it is my opinion, and it is also the opinion of the management of the Canadian National, that that has had a deleterious effect upon managerial efficiency. If you set the target at such a level that it is a challenge to management and a challenge to the personnel to make it go, then I think you are going to get the cheapest over-all transportation. If you set it too low, and if you put some of the capital or all of it in a conditional earnings class, I do not think that the challenge would be of the caliber that it should be.

Q. It is a very long time since I shot at a target, and the same thing may be true of the directors of the Canadian National, but my recollection of the matter is that it consisted of a series of concentric circles -- a bullseye, an inner, a magpie and an outer?

A. Yes.

Q. Now, haven't you defined a target in terms of the bullseye only, and isn't that a little discouraging, because there are shots like myself who sometimes get the inner or the magpie? Now, if you are really going to set a target that is to operate over time, good years and bad years, isn't it perhaps better to have these varying degrees of success, the bullseye that you hit in the very best year, and the outer that you only hit in the very worst year, so that you can mark your performance not merely hit or miss, but according to its general excellence?

A. Well, of course, I would like to think the Canadian National would classify as a sharpshooter, but---

Q. But you make the bullseye too big for that; you want to make the bullseye so big that they will be classed as sharpshooters?

A. No. I think on that score that no man knowing the full detail of the Canadian National problem can come to any

other conclusion than that this readjustment of the capital structure is a conservative one -- that is, it recognizes the principle that there should be some fixed interest-bearing capital. As I said, there were strong arguments in favour of saying that none of it should be, but there were strong arguments on the other side that said that it should be. I do not think it would be desirable that we should have access to capital funds and not have to earn a return on it. I think that necessity of earning a return is a good thing, and the only thing about it and the only way I would qualify it is, do not create a condition where under periods of average traffic we would have to ^{be} reporting deficits. Mr. Cooper, for instance, estimated that if all of the adjustments that are recommended in this brief were made in 1949, I think it was, we would only have \$13 million available after we had paid our fixed charges, and I do not think that for a year of the traffic volume in 1949 that is a very great margin.

MR O'DONNELL: : Now, unless the Commission wishes to pursue this matter further---

THE CHAIRMAN: No, no.

MR O'DONNELL: Q. Then I would remind you, Mr. Fairweather, that when you were last here his lordship the Chairman suggested -- and I think the suggestion will be found in volume 103 at page 19122, among others -- that for the better understanding of the Canadian National Railway's operations another map might be prepared, showing the lines actually owned by the Canadian National Railway Company, which his lordship referred to as a core. I understand that you have prepared such a map, which I would ask you to produce as Exhibit 270, and to make such comments upon it as you think pertinent.

The title of this exhibit, my lord, is "Map of Canadian National Railways indicating lines owned by Canadian National Railway Company."

---EXHIBIT 270: Map of Canadian National Railways indicating lines owned by Canadian National Railway Company.

MR O'DONNELL: The map is dated March 28, 1950, as appears in the lower right-hand corner.

Q. If the Commission now have the map before them, Mr. Fairweather, would you please make your comments on it?

A. This map shows in red the lines that are actually comprised within the Canadian National Railway Company. You will see from the map that it is comprised of the old Grand Trunk Railway Company, to which have been added in various parts of Canada lines which were either acquired built or were built as branch lines.

Q. That is, the lines in blue on the map are these lines other than the lines actually owned by the Canadian National Railway Company, and the principal portion of those latter lines are the Grand Trunk lines?

A. The red line is largely the Grand Trunk Railway. The scattered red lines that you see are lines that were either acquired, built or were built as branch lines. Many of those branch lines will be seen on the other exhibit, the previous exhibit.

Q. That is, Exhibit 269.

A. From which they could be identified. The blue lines on this map represent the lines of railway that are controlled by the Canadian National Railway Company either by stock control or by entrustment.

THE CHAIRMAN: Q. How do you classify the Newfoundland Railway?

A. Pardon, sir?

Q. The Newfoundland Railway?

A. The Newfoundland Railway is a blue line, and is therefore an entrusted line.

Q. It is not your line, then?

A. Oh, no, it does not belong to the Canadian National Railway Company at all. It is entrusted to us for maintenance and operation.

COMMISSIONER INNIS: Q. Would it be fair to say---

THE CHAIRMAN: Q. Pardon me a moment. It is a Canadian Government owned line?

A. It is owned by the Canadian Government.

COMMISSIONER INNIS: Q. Would it be fair to ask whether the difference implies any difference in attitude of the management toward these relative lines?

A. I can say positively that it does not make the slightest bit of difference to the management. The Canadian National Railway System is operated as an entity. The Canadian National Railway Company, which you see put out here in red, is only the authority with regard to those particular lines, the authority for their existence. So far as their operations are concerned, there is not one scrap or iota of difference between the Canadian National Railway Company lines and the other lines, nor are there any special divisions or routing of traffic or anything of that kind, and we make no report for the Canadian National Railway Company as such; our accounts are consolidated, and they represent the accounting of everything that is entrusted to the Canadian National, together with what the Canadian National owns and controls in stock ownership.

Q. Have you any accounts which set out at all the difference between them?

A. There are attempts made to keep the corporate accounts of some of these groups. Partly that is due to the, well, necessities of one kind or another, but it does not

influence management at all in the operation of them. It is purely an accounting matter.

COMMISSIONER ANGUS: Q. Is the Hudson Bay Railway in exactly the same position?

A. No, the Hudson Bay Railway is not entrusted to the Canadian National Railways on exactly the same basis. I see it is marked in here in blue, and that will need correction. The line from The Pas through to Churchill, which is shown blue on this exhibit, is the Hudson Bay Railway, and that is entrusted to the Canadian National Railway as an agent of the Government.

COMMISSIONER INNIS: Q. Does that include the branches to Flin Flon and Sherridon?

A. No, the branches to Flin Flon and Sherridon are part and parcel of the Canadian National Railway system.

MR O'DONNELL: Q. Is not the situation concerning the Hudson Bay, Mr. Fairweather, that it is fully entrusted except as to the finances?

A. It is an agent; we are an agent for operating, but we do not incorporate in our accounts the results of operation of the Hudson Bay Railway.

THE CHAIRMAN: Q. The Hudson Bay Railway begins at The Pas?

A. At The Pas, yes.

Q. And goes on to Churchill. Now, is there any other railway that you handle in the same way as that?

A. No, sir.

Q. That is the only one?

A. That is the only one.

Q. It stands by itself so far as---

MR O'DONNELL: Incidentally, my lord, I think the Commission has been provided with copies of the various Orders in Council which set out the distinctions.

THE CHAIRMAN: I know that. I want to have it in my mind now. That is the fact.

Q. The Hudson Bay is in its own class?

A. It is the one and only.

Q. Now let us come back to Newfoundland for a moment. Tell me about this Coastal Steamship Service; does that form part of the Government-owned property there, running along with the railway?

A. Yes, sir.

Q. And you are managing that too?

A. We are managing that too, but we are managing it under an entrustment order, and the results of its operations are included in the Canadian National accounts.

COMMISSIONER INNIS: Q. Do you pay running rights over that stretch of line between The Pas and the Flin Flon Junction?

A. There is an agreement; at the moment I do not know exactly what it is, but there is an agreement.

MR O'DONNELL: Q. Mr. Fairweather, is not the method of operating the Prince Edward Island car ferry the pattern for operating the Hudson Bay?

A. I am caught out there, yes. It is not a line of railway, so technically I am right, but the ferry between Prince Edward Island and the mainland is also on an agency basis. We manage it---

THE CHAIRMAN: Q. Pardon me; the ferry, do you say?

A. If you look at the map closely you see a place called Borden, and Cape Tormentine, and there is an ice-breaking car ferry that operates between there---

Q. That ferry is operated under the same conditions as the Hudson Bay Railway?

A. Broadly speaking, sir, yes.

MR O'DONNELL: Unless the Commission has some other

questions on that particular map---

THE CHAIRMAN: No, go on.

MR O'DONNELL: Q. We will go on to something else, then, Mr. Fairweather. I would like to ask you to direct your attention again to page 15 of Mr. Gordon's submission, the paragraph numbered 2, where it is said that the Government should acknowledge an indebtedness to Canadian National in the amount of \$300 million to bear interest at 3 per cent until discharged, and so on. Now, could you add anything or give any information to the Commission as to the make-up of that figure and the reason for the proposal? Mr. Cooper has already given some information about it.

THE CHAIRMAN: Did you say at page 14?

MR O'DONNELL: Page 15, my lord.

THE CHAIRMAN: What is the figure?

MR O'DONNELL: \$300 million -- the one in the second paragraph.

THE WITNESS: Well, the \$300 million figure is a matter of judgment, and it really comes back to this question of what shall be a reasonable target. In arriving at the \$300 million regard was had to the history of past earnings and to the future prospects as influenced by discernible trends that seemed to be present. Now, the past history of operations needed to be adjusted obviously for a variation in accounting procedure as between retirement accounting and depreciation accounting. The operating expenses were let us say understated in the period prior to the application of depreciation accounting to rolling stock on the Canadian National.

Another important bearing upon this matter is inflation of the dollar. That inflation of the dollar will appear in two forms -- first, that it inflates the capital

cost of replacements, and, our depreciation being figured on book cost, on the average our depreciation will not be enough to supply the replacements of the same type of equipment as are being retired. But inflation has another bearing upon the operating results, by reason of the fact that the Canadian National Railway has a low traffic density, and inflation bears with particular force upon a road of low traffic density.

Then we have also to consider the effect of highway competition. We would like to believe that the worst in highway competition is behind us, but anyone who takes realistic point of view cannot come to that conclusion. There is still a large amount of railway traffic vulnerable to highway competition, albeit on an uneconomic basis, but the trucker operating under the umbrella of a rate structure set up for the railway, although he may be from four to five times as expensive a medium of transportation, can nevertheless bid for that traffic and carry it at profitable rates to himself. The damage done to the railway economy and to the general economy of the nation is something that he is not concerned with, nor do I think in fairness he should be concerned with it. He has his field of opportunity, it is to some degree artificial, and he is exploiting it, and there is a very substantial amount of net revenue of the railways that still is vulnerable to highway traffic, only awaiting the expansion of highway facilities and the provision of more vehicles. So one had to give weight in the future to highway competition.

Then also one had to consider the effect of air competition, which is eroding the higher class passenger business, and bids fair in the future to take the major portion of the long-distance inter-city travel.

Then there is also water competition, which has

been aggressive and which is likely to be even more aggressive as facilities are improved.

Then another factor that was taken into account was the development function of the railway. The Canadian National is fundamentally in a large part a pioneer railway. You will find it throwing tentacles out to the north of our country into the last remaining frontier that we have. It is quite within reasonable prospect that development lines will be constructed. Right at the moment we have before us applications for branch lines of that nature, some of them calling for very heavy capital expenditures. Now, these development lines will dilute our traffic density. As we extend development lines we will add to our capital structure and we will dilute our traffic density during the period of development, so that we will be adding in some degree to the managerial problem, and the net income to be anticipated would be correspondingly affected. As I explained earlier, we would hope by prudent management to keep these development lines to such a proportion that ultimately they could work themselves into a real profitable adjunct to the system, but you would have to be patient and view them from a long-term point of view.

MR O'DONNELL: Q. All those considerations, as to potential earnings and earning power, were taken into consideration when arriving at the \$300 million?

A. Well, now, most of those were on the negative side of the ledger -- all of them were on the negative side of the ledger, but the picture also has the other side. We may expect an increasing population in Canada, and with that increasing population we will get an even greater physical productivity in the country.

THE CHAIRMAN: Q. Is your company by itself doing

anything to bring about an increase in population?

A. Oh, yes; we have two instruments for that. One is our Colonization and Agricultural Department, and the other is the Department of Research and Development, of which I happen to be the head, and we aid in creating opportunity, and the Colonization and Agricultural Department aid in seeing that that opportunity is taken advantage of.

Q. I have reference now, of course, to immigration.

A. Yes, I know, sir, immigration; but we do not confine ourselves to immigration, because in the Canadian economy, with the rate of increased productivity of our people, we have to find employment for a lot of people just from our own industrial rearrangement. Now, our population growth I estimated at $1\frac{1}{2}$ per cent per year; I estimated our productivity is increasing at $2\frac{1}{2}$ per cent per year.

Q. Now you are talking of the growth of the population of Canada?

A. Yes.

Q. Not of any particular area?

A. That is Canada as a whole. The Canadian National extends from one end of the country to the other. And then, as I say, physical productivity has been increasing at about $2\frac{1}{2}$ per cent, meaning of course that the specific productivity per individual is going up. But in so far as the railway is concerned, you run into a rather disturbing bit of information when you analyze the railway revenues in relation to the gross national product of the country. For instance, in 1928 it was 9.41 per cent. In 1948 it was 6.8 per cent, even after making adjustments for the rate increases that had been granted but were not yet in effect. So that what you get is this: You see Canada expanding

in size and expanding in physical production, and the railways, largely due to highway competition, finding themselves in a position where, while being an essential medium of development, they participate to a smaller extent in the economy than they might be said to do if you looked only at the historical past. It was as a result of taking all of those factors into consideration that this figure of \$300 million was arrived at as being the fair reduction---

Q. Pardon me. Just before we proceed with that, I want to ask about immigration again, does your company keep immigration agencies in foreign countries?

A. Yes, sir, we do.

Q. And they are active now, are they?

A. They are active now, yes.

COMMISSIONER ANGUS: Q. If the \$300 million is in part dealing with inflation -- and I suppose these figures, 9.41 and 6.8, really indicate that -- inflation has affected the rest of the economy more than the railway revenues?

A. No, sir, I do not think that is the inference at all. I think it is purely and simply due to this fact, that the highway competition is eroding the highly valued traffic. It leaves with the railway the bulk of the business. 92 per cent of all land transport in Canada other than strictly local delivery is performed by railway, and only 8 per cent is performed by truck, but you would be surprised to know that on the revenue side 23 per cent of the transportation revenue goes to the truck and 76 per cent goes to the railway, so that we are forced for 76 per cent of the gross transportation revenue of the country as a whole to handle 92 per cent of the business, and that, sir, is the main explanation of why we have a declining characteristic against gross national product.

Q. Well, whichever is the explanation, or whatever share they bear in the explanation, you have the two, the trucks and the inflation, which you mention?

A. Yes.

Q. What I am driving at is this: Is the \$300 million doing something that it is arguable that an increase in freight rates ought to do?

A. In my opinion, no.

MR O'DONNELL: I might just draw your attention, Dr. Angus, to what the brief says on that point at page 14. The proposal as a whole is predicated on this:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital. However, in view of the practical difficulty in the way of converting the interest-bearing capital in the hands of the public into equity capital at this time; and having regard to the potential earnings of the Canadian National System," --

concerning which Mr. Fairweather has just been speaking --

"which are considerable and may in some degree offset the adverse factors here considered; and on the assumption that the present imbalance which exists between railway rates and railway costs will be removed by adequate rate increases, I submit the following as an appropriate adjustment."

COMMISSIONER ANGUS: The reason I asked the question was that the reasons which Mr. Fairweather gave, as I understand them, trucks and inflation, seemed to be reasons that affected shall we say one railway as much as the other and would be dealt with on this redressing of the imbalance or whatever you call it by means of freight rates, and I wanted to see whether the reasons also applied

to the \$300 million.

THE WITNESS: Yes, but, sir, these things bear with particular emphasis upon the Canadian National. For instance, inflation bears more heavily on the Canadian National because it is a low density line than on other railways, and highway competition bears with heavier impact on the Canadian National Railways, and it is something that we cannot do anything about by rate increases. You see, if you look at the map down in the industrial part of Canada, where the highway competition is fiercest, you will find the Canadian National Railway, that is the heart and soul of the old Grand Trunk Railway, and that is where our high-class traffic is being eroded by the truck. We are more in that regard an industrial road than other roads in Canada. The Canadian National, sir, can be said to be made up of, broadly speaking, two types of road. One is pioneering, and the other is an intensely industrialized railway, and it is in the intensely industrialized area that we will feel highway competition in greater force than any other railway in Canada.

Now, with development lines, again that is a peculiar challenge to the Canadian National Railways, because we are on the frontier, up on the fringe of the north country and the great Laurentian Shield, which in my opinion will develop mineral resources and lumbering resources and to a minor degree settlement -- that is a bigger field for expansion by pioneer lines than other parts of Canada.

COMMISSIONER ANGUS: Q. The \$300 million, then, is really closely related to this difference which you say there is between the two railways?

A. Yes, certainly.

MR O'DONNELL: Q. And to the fact also of the difficulty of handling the debt which is in the hands of the

public, interest-bearing debt in the hands of the public?

A. Oh, yes.

Q. And to the potential earnings which the road has, all of which is based on the assumption that the imbalance in rates and costs will be adjusted properly?

A. Yes, certainly.

MR O'DONNELL: In that connection, my lord, this map Exhibit 270 I think shows the industrialized area of which Mr. Fairweather was speaking particularly, in red; and also I might just draw the attention of the Commission to the statement which appears in Part I of the Canadian Pacific Railway Company's submission, at page 113. The Canadian Pacific there says:

"The Canadian Pacific has grown up as an integrated railway system, and the majority of its traffic originates in the predominantly agricultural West. The Canadian National has been developed over the years through the consolidation of a number of independent and unrelated railway lines, and the greater portion of its revenue traffic is initiated in the industrialized East."

Q. That is what you---

A. That is what I was saying, yes.

THE CHAIRMAN: Well, we will adjourn till a quarter to three.

---The Commission adjourned at 1:00 p.m. until 2:45 p.m.

Ottawa, Ontario,
Wednesday, April 19, 1950.

AFTERNOON SESSION

S. W. FAIRWEATHER, Recalled.

EXAMINATION CONT'D BY MR O DONNELL:

Q. May it please the Commission: I would like now to direct Mr. Fairweather's attention to page 5 of Mr. Gordon's submission, to the first sentence in the second paragraph on that page, which states:

"Inflation bears with particular severity on the Canadian National by reason of its relatively low-traffic density."

You touched on that matter this morning, Mr. Fairweather, briefly, but I wonder if you would be good enough just to explain that statement in a little more detail. I understand that you have a little tabulation that serves to illustrate what you have in mind there in that statement?

A. Well, of course, it is true that inflation bears with particular severity upon railways of low-traffic density. Inflation as well as operating costs and, other things being equal, the operating cost per unit of revenue to a line of low-traffic density is of necessity higher than that of a railway enjoying greater traffic density. That simply is stating that the operating ratio is a function of traffic density, other things being equal.

It follows therefore that an inflation of the operating cost per dollar of revenue is greater for a low-traffic density line, and the granting of an increase in rates sufficient to restore the pre-inflationary net revenue of the line with higher traffic density will therefore not fully restore the net revenue of the line with low-traffic density. There will be a residuum that will not be adjusted.

I made a little example up to illustrate this

point, dealing with two hypothetical railways, road A and road B.

MR O'DONNELL: It might be a convenience to the Commission if the tabulation could be incorporated in the transcript at this point. I will hand one copy to the reporter for that purpose.

(Tabulation follows on page 20093)

EXAMPLE TO ILLUSTRATE EFFECT OF INFLATION
UPON TWO RAILWAYS OF DIFFERENT TRAFFIC DENSITY

ASSUMPTIONS:-

	<u>ROAD A</u>	<u>ROAD B</u>
Traffic Density..... (Thousands of Rev. Ton Miles per Mile).....	1500	1300
Non-Variable Expense per Mile...	\$7,000	\$7,000
Variable Expense per Thousand Revenue Ton Miles.....	6.50	6.50
Pre-Inflation Revenue per Thous. Ton Miles.....	12.50	12.50

PRE-INFLATION RESULTS:-

Non-Variable Expense per Mile...	7,000	7,000
Variable Expense per Mile.....	<u>9,750</u>	<u>8,450</u>
Total Expense per Mile.....	16,750	15,450
Revenue per Mile.....	18,750	16,250
Net per Mile.....	2,000	800

WITH 50% INFLATION:-

Non-Variable Expense per Mile...	10,500	10,500
Variable Expense per Mile.....	<u>14,625</u>	<u>12,675</u>
Total Expense per Mile.....	25,125	23,175
Revenue per Mile (44.7% Increase Required to Preserve Net Revenue of Road with Higher Density).....	<u>27,125</u>	<u>23,500</u>
Net per Mile.....	2,000	325
Reduction in Net due to Inflation.....		475

THE WITNESS: If you take the assumptions that the traffic density of road A is 1500, measured in thousands of revenue ton miles per mile, and road B is 1300 thousand, then you see you will have a difference in traffic density of a little better than I suppose 14 per cent. Now, your non-variable expense per mile -- that is, so to speak, your fixed portion of your operating expenses, which do not vary with any moderate change in traffic volume, would be the same in each case, \$7,000 per mile assumed; and if you make another assumption, that the variable cost per thousand revenue ton miles is \$6.50, you would get a pre-inflationary revenue of road A of 18,750 and a pre-inflationary revenue of road B of 16,250. The expenses would be fixed or non-variable in each case, 7,000, and variable 9,750 for road A and 8,450 for road B, or totals of 16,750 and 15,450. So your net per mile of road A would be \$2,000 and for road B \$800, although the two roads would be identical in efficiency of operation; there would not be any difference whatever except a difference in density.

Now let us apply a 50 per cent inflation. We would then find our non-variable expense in each line increased to 10,500; the variable expense would increase to 14,625 for the road A and to 12,675 for road B, giving total expenses per mile of 25,125 and 23,175 respectively.

Then if you adjusted your revenue per revenue ton mile so as to yield the pre-inflationary net of \$2,000 per mile for road A you would find that road B would only have net revenues of \$325, so that road B has fallen behind to the extent of \$475 per mile as compared with road A, due to the inflation of the dollar, and that condition would rule so long as there was a difference in the traffic densities of the two roads. It is quite independent---

THE CHAIRMAN: Q. How do you work these figures out, Mr. Fairweather? At the beginning of the assumption, you see, you have non-variable expense per mile \$7,000; that is right, is it?

A. Yes.

Q. Then you have variable expense per thousand revenue ton miles, \$6.50?

A. That is right, sir.

Q. I do not know just how you get that figure.

A. Well, this is a hypothetical case. What that really means is this, that, broadly speaking, the expense of operating a railway is divisible into two parts. One part is relatively fixed and is independent of volume of traffic; it is the set-up expense of the railway.

Q. And you put that at \$7,000?

A. At \$7,000. Then there is another expense which varies with volume of traffic, and that I have set at \$6.50 per thousand revenue ton miles. That is, my hypothetical railway on out-of-pocket operating expense would incur an expense of .65¢ per revenue ton mile. Then by applying that to my hypothetical traffic density of 1,500 in the case of road A and 1,300 in the case of road B, I get my variable expense, that \$6.50, and you see that is shown down as variable expense per mile.

Q. Yes, I understand that. What does look a bit strange to me, coming to it this way, is how you get so small a figure for your variable expenses, \$6.50 only?

A. Well, that is not far from the truth as applied to Canadian National experience. It is perhaps a little on the low side, but the Canadian National will handle additional revenue ton miles at a figure that is not far from that, about .65 or something of that order. You see, the revenue per revenue ton mile at the present time is -- what? About

1.20 or something like that, and for additional revenue ton miles the added expense within a moderate increase is about .65. Of course, it won't hold if you vary the traffic more than about 50 per cent; after that you would get into another cycle.

MR O'DONNELL: Q. These assumptions that you have set out there at the top of the tabulation with respect to non-variable expense are expressed in terms or units different than the variable expense?

A. Well, in the fixed expense it is dollars per mile, in the other it is dollars per unit of traffic.

Q. Per thousand revenue ton miles?

A. Per thousand revenue ton miles, the revenue ton mile being the unit of useful work performed, and it simply illustrates this, that the operating ratio of a railway is a function of traffic density. The general formula is that the operating ratio is equal to a constant divided by the density of traffic, and then to that fraction an addition of an out-of-pocket ratio. The formula for the Canadian National and for Canadian railways generally at the present time I may say is that the operation ratio R is equal to 8,270, divided by the density of traffic in dollars per mile, plus .54, and that will produce the operating ratio with moderate changes in traffic density. You will see that the traffic density is very potent, because the increment or decrement of the operating ratio varies as the square of the traffic density. The $\frac{dy}{dx}$ of that equation is proportional to $-\frac{1}{D^2}$.

Q. In any event, this tabulation serves to illustrate the effect of inflation upon two railways of different traffic density?

A. Yes, that is what it does.

Q. And you previously told the Commission this morning

and the statement of Mr. Gordon is that the Canadian National with its low traffic density is particularly affected or affected with particular severity by inflation?

A. Oh, yes, it follows, it follows quite logically.

Q. And I think you also mentioned that as compared with Canadian National, in your view the Canadian Pacific had a higher traffic density?

A. Oh, their traffic density has been consistently higher than that of the Canadian National, except for a brief period during the war when, due to the excessive traffic conditions of the war, particularly the tremendous overseas exports and the industrial development of the war, the Canadian National did for a very brief period climb up to the traffic density of the Canadian Pacific, and you could immediately see the results in the operating ratio of the Canadian National.

Q. Now, Mr. Fairweather---

A. That was a most extraordinary condition. The typical condition is that we lag behind the Canadian Pacific in traffic density about 10 per cent.

COMMISSIONER ANGUS: Q. What period have you in mind as the pre-inflationary period?

A. In this particular example, sir?

Q. Well, if we were to apply this hypothetically.

A. Well, I would say that if you want to take the present-day conditions, I would say I would look on 1939 as pre-inflationary.

MR O'DONNELL: Q. Now, Mr. Fairweather, would you be good enough to turn to the main submission of the Canadian National Railways, which is Exhibit 214? It occurs to me that it might shorten proceedings if I just referred briefly to the part that I am interested in. I understand, Mr. Fairweather, that you are the officer of the Canadian

National Railways who prepared that section of the main brief entitled "THE CANADIAN NATIONAL AND ITS OPERATION OF LINES OF RAILWAY IN THE PUBLIC INTEREST" -- that is at page 64. You were the officer of the Canadian National Railways who prepared that section of the main brief, which is set out at pages 64 to 72 inclusive?

A. Yes.

Q. You have there made reference to the burden which the Canadian National has been required to assume in its operating expenses by reason of the losses attendant on the operation in the public interest of certain extensive lines of railway, and in general, by way of summary, I might say that you have made reference to the fact that a large portion of the Canadian National System consists of development lines and a further substantial mileage arises from functional duplication of previously existing competitive systems, that the location of still other lines has been influenced more by strategic than economic conditions, and this all has resulted in a relatively low-traffic density, which is the basic explanation of the widely varying results of operation from year to year; and you have there referred to the difficulties attendant upon the co-ordination of these lines, and have pointed out that a greater mileage of railways exists in the Canadian National than would have been necessary if the system had been planned as an entity. You have further indicated in those pages that the continued maintenance and operation of such duplicate and extra mileage is a burden which adversely affects the earning capacity of the property, and you have referred to the problems presented by branch lines (page 66) and the disabilities arising from the inclusion in the Canadian National system of circuitous routes, the location of which were influenced by strategic or political reasons,

which are in competition with shorter routes (page 68), and to the burdens arising from the operation of small railways, previously independent and constructed to low standard. Then between pages 70 and 72 you explain Exhibit "A", which is illustrative of the problems flowing from the relatively low-traffic density previously referred to. Now, is there anything further that you care to add at this time to the matters I have just mentioned, which are in fact set out in some detail between pages 64 and 72 of the main brief?

A. No, it does not occur to me that I might add very much at this time to what was set out in the main brief. As a matter of fact, a good deal of it has already been touched on in discussing Mr. Gordon's submission.

Q. Well, would you refer possibly to this Exhibit "A" attached to the main brief, which was filed separately as Exhibit 215, and explain that map briefly?

A. Well, this map was intended to give an indication of the relative profit of different sections of the Canadian National system. Every railway system has lines that are thin traffic and are unprofitable for that reason, even when you take feeder value into account. The particular classification of the Canadian National lines is based on gross ton miles per mile of line.

Q. That is for the purpose of this particular Exhibit 215?

A. Yes. Had revenue ton miles been available in the detail required at the time the map was prepared, both figures would have been shown. Each has a value. The revenue ton mile is a measure of the effective transportation work performed, and the gross ton mile is a measure of the actual transportation work performed. The broad classification of these lines are in three groups -- those of the traffic

density at 250,000 gross ton miles per mile and under, those with a traffic density between 250,000 and 1,500,000 gross ton miles per mile, and lines of traffic density over 1,500,000 gross ton miles per mile. This classification was intended to illustrate the nature of Canadian National operations. The red lines on this chart or map are those lines where the traffic density is below the first critical measure. That critical measure is that after allowing for feeder value to the balance of the system they still come out in the red. That is, a line of railway being credited not only with the revenue which might be apportioned to it on a pro-rate of the work performed, but also having credited to it all of the revenue on the traffic which originates or terminates on it or passes over it and still produces a deficit condition on operation -- that is, it fails to add anything to net revenue -- would be classified as red.

Then at the other extreme there are those lines which enjoy sufficient traffic so that they pay their way even if they are only credited with that portion of the revenue arising from traffic passing over the line or originating and terminating on it, which would be pro-ratable to the line on a ton mile base, and under such conditions produce sufficient revenue to pay their expenses. That would be the green, the lines coloured green.

Q. That is, pay their expenses without even taking into consideration feeder value to the rest of the system?

A. Without taking into consideration feeder value to the rest of the system. Then the intermediate zone is the yellow. In the case of the yellow lines, they may be said to contribute something if you credit them with the feeder value; that is, they are in an in-between state. But of course you must be cautious when you make such an analysis,

because when you credit feeder value to one line you must necessarily take away a corresponding amount of traffic from some other line, and this classification therefore can only be looked upon as a criterion of the relative standing of lines; that is all it can be.

COMMISSIONER INNIS: Q. How do you explain the green streak between Cochrane and Nakina?

A. Between Cochrane and Nakina? Well, that has a traffic density of 1,915. The reason for that, as I recall it, is, there are very heavy pulpwood operations in that area, and that is why that traffic has the density it has.

Q. I assume it is the Canadian Northern -- it is not shown -- that takes off the traffic, is it, or the Ontario Northern?

A. Well, that traffic would be moving -- yes, it might be moving down -- now, let me see: I think there is a pulp mill in there, isn't there? There is a pulp mill in that piece.

Q. Two of them.

MR O'DONNELL: The Abitibi, isn't it?

THE WITNESS: At Kapuskasing there is, I think, one of the largest pulp and paper mills in the world, and it is for that reason that we get the condition indicated.

MR O'DONNELL: Q. It is the sub-marginal group, is it not, that consist of the thin traffic lines?

A. Well, the sub-marginal group is definitely the red group on this chart, and they consist of lines which, even when you give feeder value to them, do not earn enough to justify themselves as a railway venture. That does not mean that they are not valuable in the national interest, but it certainly means that earnings must be found somewhere else on the system to pay the losses incurred in these particular lines; and the ability of the railway system to continue to

supply service in such cases is conditioned to its over-all net revenues secured from the other more favourable lines, in other words to its over-all traffic density. And that brings me back to what I have said previously about the Canadian National: Being a line of relatively low-traffic density, it finds the burden of the sub-marginal lines greater than would otherwise be the case. As revenues decline, as they do in business cycles and under the effect of highway competition, there is a tendency on the part of management to scrutinize these thin traffic lines, and if the traffic seems to be too far out of line with the expenses an application may be made to abandon service, with the objective of improving the system net.

THE CHAIRMAN: Q. An application to whom?

A. It would be to the Board of Transport Commissioners. Almost invariably hardship to the communities affected must be anticipated, and it then becomes the duty of the Board of Transport Commissioners to judge whether the improvement in railway net revenues which would result from abandonment is sufficient to justify the loss of railway service to the communities affected. I might add that this general problem of thin traffic lines is aggravated by highway competition. With highway competition it becomes increasingly difficult for the system to continue the operation of these thin traffic lines, due not alone to the direct highway competition in the territory served but also the general effect of highway competition in reducing railway net revenue.

THE CHAIRMAN: Mr. O'Donnell, I think we dealt before the adjournment in March sometime with this question of abandonment and what had been the result of applications for abandonment to the Board.

MR O'DONNELL: That is right, my lord.

THE CHAIRMAN: We dealt with that.

MR O'DONNELL: Yes, we did. My memory is that we had a statement in there of the number of applications which had been made over a period of years and the disposition which had been made of them.

THE CHAIRMAN: Either we had the statement or it was agreed that we should have one; I am not sure which.

MR O'DONNELL: That is my memory offhand, my lord. I think that is the fact. I do not intend to pursue it.

THE CHAIRMAN: I know, but the matter is going to be reported in another phase of our inquiry. I suppose, Mr. Covert, you could tell us about that.

MR COVERT: My recollection, sir, is that it was discussed, but I do not think it has been put in yet.

MR O'DONNELL: I may be in error there. I remember it was discussed -- at least, that is my memory, anyway. However, that could be procured if the Commission were interested in it. I would assume that most of the judgments are reported.

(Page 20108 follows)

THE CHAIRMAN: Well, Mr. Covert has a note of it now.

MR. O'DONNELL: Then, Mr. Fairweather, the next thing I would like to direct your attention to, if the Commission has no further interest in these maps, is the matter of agreed charges. Agreed charges have been discussed many times, actually, and I do not intend to take any time.

THE CHAIRMAN: Have you the chapter on them?

MR. O'DONNELL: Yes, and I intend to direct your lordship's attention to the chapter in the brief, 171 to 181, and I was simply going to ask Mr. Fairweather to say that he is the officer of the Canadian National Railways who has had to deal with this particular section, and that the views of the Canadian National concerning this matter are set out there in some detail.

I understand, Mr. Fairweather, that you attach some very particular importance to the matter of agreed charges and that your company's views are set out in the pages that I have referred to --- pages 171 to 181?

A. Yes, that is correct. The agreed charge is, in my judgment, a most highly important aspect of the complex problem created by highway competition, and it is about the only means that the railway has of effectively meeting the competition afforded by the motor vehicle. The justification of the agreed charge must necessarily be a matter of broad national interest, and it is not because it is of advantage to the railway that it is being urged -- it is because the agreed charge is of advantage to shippers generally and particularly to those shippers who most need railway service because they have not anything else available, these people out on development branch lines who must depend upon the railway for their service and who,

in the past, have been afforded service at less than cost because that cost was assessed against other traffic.

In so assessing, a condition was produced where the traffic became vulnerable to highway traffic operators and, notwithstanding the fact that the railway is only about one-third as expensive a medium of transportation as the highway carrier, nevertheless, the highway carrier comes in and he roads the traffic. Now, when that happens, it throws a burden upon the whole railway transportation of the country, and that burden tends to fall upon the chap who really needs the railway service.

THE CHAIRMAN: You say at page 175 your agreed charge is now about \$5,000,000 per annum?

THE WITNESS: Yes.

THE CHAIRMAN: Q. Now, can you tell us what would have occurred if you had not had these agreed charges in operation?

A. Well, the chances are we would not have had the traffic.

Q. That would be \$5,000,000 less?

A. Yes, but the agreed charge principle which was introduced into the Canadian rate structure was copied from English procedure.

Q. I noticed that.

A. But it has been applied in Canada with more cumbersome machinery and the railway finds it a very ineffective medium.

Q. You mean to say that the British system is less cumbersome -- they have more facilities for making these charges?

A. Yes, the British system is much less cumbersome than the Canadian.

Q. Pardon me, that raises a question. I do not know anything about it yet. In Great Britain, of course,

they have government ownership of railways. Have they any Board that has to be applied to or that might be applied to in these questions of agreed charges?

A. Oh, yes, there is a Board similar in a good many respects to the Board of Transport Commissioners, but, broadly speaking, the main distinction is this, that in England, if somebody thinks that he is injured by an agreed charge, he can go to the Board and if he can make a case, he can get an agreed charge applied to himself, but he cannot prevent the original agreed charge being applied. That is a matter very similar to a competitive rate.

Q. He cannot prevent the agreed charge between the original parties?

A. No.

Q. But he can apply to come in under it himself?

A. Yes, to get a similar one if he can show cause that he should.

MR. O'DONNELL: Something like the fixed charge that we have in our rate structure?

THE WITNESS: Yes.

THE CHAIRMAN: Something like what?

MR. O'DONNELL: The fixed charge that is provided for in Section 35 of the Transport Act, 2 George VI, Chapter 53. We have discussed that several times.

THE CHAIRMAN: What about the United States?

THE WITNESS: There is no such legislation in the United States. In fact, I do not know of any place in the world except the English experiment.

Q. When did the English experiment begin?

A. Well, it began in exactly the same way --

Q. I said when?

A. Oh, it began, I think, about 1933. We sent a man over to the Old Country, and looked into it, and thought it was a good idea, and it was introduced

into Canada, but it was handicapped in Canada at hearings before the Board so that any person objecting to an agreed charge could go and be heard before the agreed charge was put in, and it makes it a very inflexible tool. An agreed charge fundamentally is nothing but a special form of competitive rate, and that is the way it should be treated. It obviously needs some reasonable and rational control, but the present basis is quite cumbersome, and what is proposed by the Canadian National is simply to make the agreed charge more workable.

Q. Are you proposing a system similar to the British one?

A. Very much.

Q. Mr. O'Donnell, you referred just now, or used the language, rather, of "fixed charges", Section 35?

MR. O'DONNELL: Yes.

THE CHAIRMAN: What did you have in mind there?

MR. O'DONNELL: That anyone who is not entitled to, or did not come into the agreed charge, may obtain a fixed charge if he be prejudiced and can show that he is under the same sort of conditions.

Well now, your reasons are set out in some detail, as I said, in the brief, and the amendment which was proposed appears at pages 180 and 181 and since the brief was prepared, I believe that there were two slight changes in the amendment as proposed, and that an amendment has now been substituted for that. The changes are to the effect that any part of the goods of a shipper may be covered by an agreed charge and that a competing carrier might participate in the negotiations and have the right to join in making the agreed charge and with the procedure for the filing with the Board of the agreed charge, and of its becoming effective, and these things as suggested now

are slightly different from paragraph 2 of the amendment as set out at page 180 of the brief?

A. Yes, that is all that is involved in the proposed suggested change.

Q. And copies of the amendment have been filed with the Board.

THE CHAIRMAN: You mean copies of this proposal?

MR. O'DONNELL: Yes, my lord, they have been filed with the Board.

THE WITNESS: They do not change in substance what is proposed; what we aim at is a flexible method of dealing with the constantly changing pattern of competition and doing it on a basis where we will get the traffic with assurance.

THE CHAIRMAN: Mr. O'Donnell, has the Board commented at all upon these proposed amendments that you have handed to them?

MR. O'DONNELL: You mean the Board of Transport Commissioners?

THE CHAIRMAN: Did not you say you filed them with the Board?

MR. O'DONNELL: I meant the Commission. We filed them with the Commission some days ago. That is all I have to ask Mr. Fairweather.

THE CHAIRMAN: Anybody else wish to ask Mr. Fairweather any questions?

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EXAMINATION BY MR. COVERT:

Q. Mr. Fairweather, I wanted to take up with you just for a moment the question of the growth of population of the country and its effect on the railways. Now, I think you were discussing the matter this morning and you referred to figures which you had in 1928 and 1948,

I think, 9.41 per cent, you said, and 6.8 per cent.

I was not quite sure just what those figures were. Could you tell me that again?

A. Those figures relate to the fraction which the railway industry in Canada was of the gross national product of Canada and it was, therefore, sort of an index of the relationship of the industry to the whole economy and the important part was that it had shown a decline. That decline was not something that pops up suddenly; it has been manifest ever since, I would say, about 1930.

Q. Did you in the process, prepare figures for all the intervening years?

A. Oh, I have at various times made that study and I say that it shows a declining characteristic.

Q. I wonder if they are readily available if you could file that with us because, taking two years, 1928 and 1948, might not be as indicative as they should be of just what the true situation is?

A. I do not know. I rather think they are fairly indicative. 1928 was a boom year and 1948 was pretty well a boom year and there you have the comparison. However, if you will give me time to compile the figures, I would be very happy to compile them but you will find they show a declining characteristic.

Q. Now, for instance, in 1948 I wanted to check with you if that took into account the effect of the changing rates?

A. Yes, I adjusted that.

Q. And then in 1928 whether there was or not a similar situation?

A. There was no similar situation in 1928.

Q. Then, I think the war years may be very interesting?

A. Well, they might be interesting but I do not know what they would indicate except what happens in a war.

Q. Now, when you say that, Mr. Fairweather, these are using dollar figures, aren't they?

A. Yes, those are dollar figures.

Q And in the war years do you say that the tonnage carried by the railways was much greater than, say, in 1949?

A. Yes, it was some greater than 1948 during the peak of the war but, of course, there are many other things that take place during a war. For instance, in the last war you simply had to concentrate your transportation on the most efficient medium. Therefore, by controls you prohibited the haulage of goods on the railway and by so doing you increased traffic on the railways. You did it because you could not afford the man-power and the material to be wasted by handling it on the highways but as soon as the war ended, that condition ended. Moreover, the war called for a very great simplification of our industrial pattern. We had a few simple objectives. They looked complex enough in carrying out the war but as compared with the peacetime economy, they were much simpler and the result was that railway activities in the war are a thing quite apart; they did not stand in relationship to peacetime operation at all and any attempt to compare those peacetime and wartime operations of the railways are like comparing chalk and cheese.

Q. Would you say that traffic density would be entirely different during the war?

A. As I said, one effect of the war was, for a temporary period, to permit the Canadian National traffic density to rise to that of the Canadian Pacific but that was an ephemeral condition.

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Q. Do you say that the traffic density decrease for the railways generally during the war differed more than during peacetime?

A. Oh, yes, every modern war has shown that.

Q. At the same time, when you were discussing this you also used some figures about the volume -- I believe it was the volume of goods carried by the railways as compared with the trucks and the percentage or perhaps you used the term percentage of transportation by railways and by trucks and the returns from the two. I think you said that although 90 some per cent of the goods were carried by railways, approximately 23 per cent of the revenues went to the trucks. Is that correct?

A. Yes, that is correct.

Q Now, are those the same figures, Mr. Fairweather, that were given by the Railway Association in their Brief?

A. I believe so, yes.

Q. And there is not any additional information that you have where you got those figures than is contained in that brief?

A. No, it is the best estimate we can make.

Q. That is an estimate?

A. Yes, it is an estimate. There are no statistics but I may say that their reasonableness has been tested by comparing them with the United States where there are statistics and I am reasonably certain that these statistics are within shooting distance of the truth.

Q. Then, on the question of the growth of population, Mr. Fairweather, I take it that you are not particularly optimistic that the increase in population is adding greatly to the improvement of the position of the railroads?

A. I think it does add very materially to the

position of the railways but there are other adverse factors. It is one of the positive factors.

Q. But the negative factors outweigh the positive factors?

A. Well, I did not say that.

Q. Well, I am asking you?

A. I would not say that. I certainly am of the opinion that railways will continue to be the backbone of our land transportation and must always be so. They are the cheapest medium of land transportation. The railways are going through a difficult period at the present time. Part of that difficulty arises from uneconomic competition.

Q. On that point, do you think that right now that what you refer to as "uneconomic competition" refers to the trucking only?

A. Yes, partly. There is also uneconomic water competition too.

Q. You say that this uneconomic competition, that that is the main problem, do you?

A. That is one of the main problems.

Q. And you think that to-day that is serious?

A. I think it is very serious. I have estimated that if you had this thing under control so that uneconomic competition between railways and highways was eliminated, the net revenues to Canadian railways would be over \$100 million greater than they are. That is how serious it is.

THE CHAIRMAN: Then, you are looking forward to having this uneconomic competition reduced?

A. I would hope that some means would be found to do it but I will say this, sir, that no country in the world has come forward with a solution yet. It is about the toughest problem that faces the transportation world.

Q. Well, has not that to do with your confidence in the transportation by railways in the future?

A. Well, despite this what one might call canker you still have the broad economic condition that the only means of transport capable of moving the country's goods with enough left over to induce production is the railway. The basic commodities of this country, the coal and the iron and the iron ore and the ore concentrates and the pulpwood and everything of that nature will have to move by railway because the cost of moving it by rail is so much less than the cost of moving it any other way but that is not the entire problem by any manner of means. The problem of supplying railway transportation so that you will maximize development in your country is a very great problem indeed and in the past that problem was worked out by a discriminatory rate structure in which the higher rates were charged far beyond the cost of service and the profit or it was used to extend services to raw materials and to move the commodities that could not afford it.

Now, the taper that was in your rate structure was a double taper. One was a taper depending upon the value of the commodity moved and the other taper was one of the distance it moved and, broadly speaking, it worked out to afford some sort of an economic opportunity to people spread throughout the length and breadth of the country. Well, it is artificial in a sense. It can only work when you have, let us say, a functional monopoly. Your functional monopoly is shattered by highway competition and by shattering it destroys the railway's ability to obtain enough money from the higher valued commodities to extend to as great an extent as formerly or as great an extent as I feel it should be

done, cheap transportation to the development people.

I am Chief of Development of the Canadian National Railways, and, as such, I have a very lively appreciation of the importance of freight rates to people who are developing this country -- a very lively appreciation of it, and when I see \$100 million a year diverted from railway net with no advantage to the economy of the country, I naturally am very much concerned as a development person.

Q. Now, we have heard before, of course, a great deal about why it is considered from the point of view of the railways that the truck competition is uneconomic but I think you mentioned a while ago the water competition as also being uneconomic?

A. At times, sir, yes.

Q. How do you explain that?

A. Well, I think that, for instance, carriers on the St. Lawrence waterways, do not pay one cent for the use of water and in the same way coastal vessels pay nothing whatever or, at least, very little for the use of facilities and aids to navigation and all that sort of business. I would not say that the erosion of railway net by water competition is a serious thing at all; I do not think it is because actually water competition is mostly limited to those commodities that move in bulk and the water shipper, broadly speaking, is sharing with the railways the job of moving the basic commodities of the country at extremely low prices.

There is some competition that, in my opinion, is uneconomic but I do not think it is serious. The really serious nub of the thing is the uneconomical highway competition.

COMMISSIONER INNIS: You do not think trucks would be justified in referring to the railways as

uneconomical?

A. I would challenge that and I would debate it before any body. I know what I am talking about when we move goods at an out-of-pocket cost of less than one cent per ton mile. I defy any truck concern to handle goods at a cost out-of-pocket of lower than three cents per ton mile.

MR. COVERT: You say that is a fair comparison -- the half cent is an average for all your traffic?

A. I do not understand your question.

Q. Did not you say a half a cent per ton mile?

A. No, I said less than a cent.

Q. Would you say that is the average for the whole?

A. I would say that is a representative average out-of-pocket cost. Now, you take heavy loading commodities like iron ore or coal moving in favourable conditions on trainload lots our out-of-pocket costs might be lower. In other cases it might be higher but that is a fair average.

THE CHAIRMAN: I understand on account of the shortage of reporters you wish to adjourn?

MR. COVERT: Yes, I think we will adjor adjourn now, sir.

---Recess.

MR. COVERT: Mr. Fairweather, the railways do on some traffic receive much more than three cents per gross ton mile for hauling traffic?

A. Oh, yes, that is the very problem. You see, this juicy traffic is the stuff the trucker goes after and let us say his out-of-pocket operating cost is three cents per ton mile as he counts it. His true cost is probably around five and the cost to the country

including the upkeep of the highway would probably be eight cents per ton mile and the railway, let us say, has a rate of 10 cents or 12 cents a mile on that particular high valued traffic. You do not need to go very far to see what happens.

Q. In connection with that growth of the population, do you say that the growth is increasing largely in areas where there is apt to be this truck competition?

A. Yes, I do. The characteristic of the Canadian economy is this, that we are practising an industrial and an extractive economy. We are mechanizing our extractive economy and the result is that one man located out in the development area is doing the effective work that perhaps five or six men were required for when, say, you and I were boys.

Now, the result has been that there has been a trend toward urbanization and the cities of Canada are growing in population. The extensive extractive industries are not supporting directly the large population and it is in the industrialized and urbanized sections of the country that the highway operator is keen. You do not find these highway operators terribly concerned in going after this traffic of a development nature. They leave that to the railways.

Q. Now, I think you also said, Mr. Fairweather, that this problem had not been solved anywhere satisfactorily?

A. Yes, I said that.

Q. And I suppose that in Canada, the solution is perhaps more difficult than in other places?

A. No, I would not say it was more difficult than in other places but it is certainly difficult. It is difficult in Canada because you have a highway under ten

Jurisdictions and the federal authority has not seen fit to regulate interprovincial highway transport and my department is charged with the legislative and regulative aspects of highway competition as against the railway and we have made appearances before these provincial bodies. They will give you a sympathetic hearing but they will not base their decisions upon national public convenience and necessity. They look upon it from the provincial point of view and when you argue with them on the principles that I have touched on here, you get nowhere as you would expect. But I do want to say this, that restrictive legislation or restrictive regulation is not the answer to this problem; that has been tried many places and has failed.

THE CHAIRMAN: What do you mean by "many places" -- other countries?

A. Other countries, sir, and neither have I too great faith in a type of regulation which attempts to put the highway operator under precisely the same form of regulation as the railway. The two types of transport are fundamentally different -- one is by the very nature of its operation a functional monopoly and the other partakes of an open-ended economy. Anybody can get into trucking who has the first payment to put up on a motor truck and that has to be realized.

Q. Well, what is your suggestion?

A Well, one suggestion is that this agreed charge be made effective and flexible so that it can be used. That is a practical suggestion. For the rest, I think it is a problem which requires very careful study. I think that certainly the jurisdiction of federal and provincial government in highways and rail transportation and the economic effect of the present set-up needs to

be very carefully examined and I would hope that out of it would come some recommendation that would allow the two services to be co-ordinated because I know perfectly well there are lots of opportunities where trucking can co-ordinate with railway services to produce a better joint service than railway by itself or the highway by itself.

We have, for instance, an example down in Prince Edward Island. We made a thorough study of the situation in Prince Edward Island and decided down there that a co-ordinated service would be better than the service that they have to-day and we have made representations to Prince Edward Island relating to the establishment of a co-ordinated highway and railway operation and we are awaiting word from the province as to whether they will give us the required licences.

Q Then, you referred to places where restriction has been tried but has failed?

A. Yes.

Q. Can you tell us anything about that?

A. Well, just about every possible form of regulation has been tried at one time or another.

Q. You mean in the United States?

A. In the United States, over in Europe and they are still being tried -- in Australia, New Zealand, in Ireland, Great Britain, France, Germany -- almost every country that is faced with this problem has at some time or another tried to resolve the problem and I have never yet seen a solution.

Q. You see, some of those countries you mention are not handicapped in the way we are here; they have only the one parliament and one government and they have

control over all transportation and still they have not come to any solution?

A. Yes, I admit that. It is a baffling sort of problem but that it is a problem cannot be denied and I would think that like any other problem, the element of solving it is to study it and study it in detail and study it whole-heartedly and with a desire to really get at the facts and to leave prejudice out of it as far as it is humanly possible to do and to see then where it is possible to work out some form of control and still allow both highway and railway performance to operate within a natural field of economy so that they would add by their joint service to the public good.

Q. But you yourself have not so far been able to work out any scheme?

A. Well, I have speculated on it a good deal. I have some personal views but I do not know that I would want to weary the Commission with my personal views.

Q. Bearing in mind that we are in Canada, where as you say, we have so many jurisdictions over transportation?

A. It makes it difficult in Canada, I quite admit, but the fact that the problem is a difficult one to my way of thinking only makes it the more important that it be studied.

MR. COVERT: Mr. Fairweather, I suppose the problem would be more acute in a country like England where you have shorter hauls for most traffic -- it would be even more acute there?

A. It is acute in England and it is acute in the United States and it will grow acute in Canada to the extent that highways are extended and more trucks are made available. One of the things you must keep in

mind is this, that this artificial opportunity that I keep referring to is related to the discrimination that is in the rate structure. Now, that discrimination is greater in Canada than it is in England because we have longer hauls, if you get my point.

THE CHAIRMAN: You use the word "discrimination", do you?

A. I use the word "discrimination" in its dictionary sense. Certainly the railway rate discriminates between one shipper and another based on the value of his commodity and if that were all there were to it, it might be unjust but what makes it just and in the public interest is that the railway takes the surplus earned from the high valued commodities and used it to support the movement of the low valued commodities or at least that is what happened in the past. The real highway problem is not that the railways are losing that revenue; it is that the railways are losing their ability to maintain that rate structure which is so essential to our development. That is the real problem. It is a national problem and not a railway problem. It is with the solution of that problem that I, as a development officer, am generally concerned.

COMMISSIONER INNIS: Do you favour government subsidies to support that?

A. Well, I do not like the idea of subsidies as such and yet anybody who studies the rate structure of the railway from a development angle must realize that it is in fact a complicated subsidizing scheme anyway. You subsidize the basic producer by allowing an excess charged on somebody else. Therefore, you have in fact delegated to the railway taxation powers and subsidizing powers and it is a complicated economic picture.

Now, if the scheme departs from that pattern, rather than seeing the development stymied and failing any other solution, I would seriously consider subsidies because I think the development of these marginal producers is the whole foundation of our basic development in Canada. I have flown all over our pioneer fringes. I have travelled by rail and car and by foot and everywhere I go I find the same story, that it is transportation at the primary producer that is the controlling factor in development and it is because of this hampering influence, let us say, which is the main factor of highway competition that I am so concerned.

THE CHAIRMAN: Tell me this -- suppose you had the unfortunate position where you had to say: "Well, nothing can be done about it," then what would be the result on the railways?

A. Well, I think, as I said before, sir, when you get right down to bedrock, the railways must remain the backbone of the transportation system of the country but you can either have a railway system that is performing a maximum function or you can have one that is performing a function after a sort and that is the picture that I would envisage if you could not do anything with highway transportation.

What would happen, as I see it, is this -- there would be a tendency to withdraw service from these development lines. There would be a tendency to look very much askance at any extension of development lines because the railway industry would be, so to speak, in the poor house and you would, therefore, find somewhat of a check placed upon the development of the country.

The transfer of those marginal producers to a burden which no longer can be shared with the higher

valued commodities may very well have the effect of driving them out of production.

Q. Their rates would have to go up?

A. Yes, and if they go up it foreshortens their field of profit and if it foreshortens their field of profit there are going to be fewer of them producing fewer things and we are going to see a less extensive development.

Now, I said that rather than face that as an ultimate picture and failing any other picture, I would think that some form of subsidy would be considered but that is my personal opinion.

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THE CHAIRMAN: Q. You mean subsidy to the railways?

A. It would necessarily have to be to the railways, because they are performing the service. They cannot collect the rate and maintain production.

MR COVERT: Q. Now, Mr. Fairweather, has your experience shown how a competition is much more severe in its effect on the railways during the depression than during a period of good times?

A. Oh, that is a very complex question. It has both its plus and minus sides. During a depression, of course, you will get the chiseller who will break wage agreements and hire men for next to nothing and the men will work for it. That is on the positive side, let us say. On the other side of the thing is that during a depression a trucker finds it himself very difficult to get credit to expand his operations, so just what comes out of it in the end I would not know. There are both plus and minus factors. I know that we have found that highway competition has been an increasing factor from its very inception through good times and bad, except during the period of the war, when the state stepped in and said, "Because we cannot afford the gasoline, we cannot afford the manpower, we cannot afford the tires, you cannot get these things," and they shut off the access to supplies, and by that means the amount of highway traffic dropped to insignificant quantities. But bearing such action as that, the erosion of highway traffic, erosion by highway operators of railway traffic, has been an increasing factor through good times and bad, and, as I said before, the end is not yet.

Q. Now, I think you said that restrictive legislation was not the answer, and I just want to be sure that I under-

stand what you mean by restrictive legislation. You mean---

THE CHAIRMAN: Pardon me. It was a factor during the period when the restrictions would not allow the truckers to get what they needed.

MR COVERT: Yes.

THE CHAIRMAN: Q. That was a factor, wasn't it?

A. That was a factor, sir, but I do not think it would be feasible in peacetime, not in a democratic country.

MR COVERT: Q. By restrictive legislation you mean legislation that prohibits trucks or competitive forms of transport from operating beyond a certain area -- things like that; is that what you mean?

A. That is what I mean. I think that whatever is worked out should allow at least the appearance of a free market, where a person can operate his truck in competition with the railway and a shipper can choose his service as he pleases; but I think, if I may say so, that every rate, every railway rate in Canada, is inter-related, and the real difficulty we are faced with is that shippers and the public generally do not realize that. They do not realize that a rate on pulpwood moving from a forest area to a pulp mill is actually related to a rate on the movement of an automobile from say Oshawa to Montreal, and yet there is a relationship between the two rates. Now, it is the picking and choosing by shippers -- where they pick from these highly related rates, they only pick the rates that suit their particular field, and in doing so they practise discrimination against the rate which should be available to the primary producer. We simply cannot have our cake and eat it too, and that is the fundamental situation as I see it, that we think we can. I certainly do not blame a shipper when he has an opportunity of shipping his goods by truck say at cheaper than the rail rate, I do not blame him for shipping,

but it should be worked out in some sort of manner that he should not have that opportunity.

THE CHAIRMAN: I understand we have to pause again, on account of the stenographic situation.

MR COVERT: Yes, that is right, for about five minutes, Mr. Chairman.

(Recess)

MR COVERT: Q. Mr. Fairweather, I wanted to take up with you just for a moment this exhibit that dealt with development branch lines; it is Exhibit 269. I wanted first to ask you if you draw any distinction between development branch lines and other branch lines?

A. No, no practical distinction -- not in these days, anyway.

Q. Then on Exhibit 269 there was a line, I think it is between Hanna -- you see your numbers, 42 and 44 -- from Hanna to Hemaruka?

THE CHAIRMAN: What province is that in?

MR COVERT: That is in Alberta, Mr. Chairman.

Q. It is number 42, is it?

A. Yes.

MR O'DONNELL: 44, isn't it?

THE WITNESS: Hemaruka to Scape, that is 44; and 42 is Bulwark-Airways.

MR COVERT: Q. You see the one I want?

A. You want 43, I think. 43 is Loverna to Hemaruka, in here.

Q. That is the broken one?

A. Yes.

Q. That is number 43, is it?

A. 43.

Q. I just wanted to make sure that I had a complete list of the broken line ones, which are not fully completed for operation.

A. Well, they are all shown on the map.

Q. I just wanted to make sure that I had the right numbers.

A. I think there are five of them altogether.

Q. One is Sunny Brae, and the next one is 28, that is Neidpath and Swift Current, and then 38 is St. Walberg---

A. 38, St. Walberg-Bonnyville.

Q. 42, Bulwark-Airways?

A. Yes.

Q. And 44?

A. 44, Hemaruka-Scape.

THE CHAIRMAN: That is the one we just looked at.

MR COVERT: Q. That is 44 rather than 43, is it?

A. Yes, 44. It is the line from Scape, you see, over to Hemaruka.

Q. And part of it is completed?

A. Yes, sure.

Q. From Scape to Hanna?

A. Yes.

Q. Those are the only five where they are uncompleted?

A. Yes, of the branch lines that were initiated after 1923.

(Page 20144 follows)

Q. The next point I want to take up with you is, you mentioned this morning substantial expenditures that have to be made in Newfoundland for new terminals and new ships, and so on?

A. Yes.

Q. And I think you also said that all of the rail would have to be replaced?

A. I said yes, in about ten years.

Q. I suppose you will be giving consideration, if you have to replace all the rail, or the Canadian National will be giving consideration as to whether or not there will be a change from the narrow gauge to the ordinary gauge?

A. You mean the standard gauge?

Q. Yes, the standard gauge.

A. It is my opinion that the narrow gauge is suited to the operations in Newfoundland. If we tried to apply the standard gauge to Newfoundland we would find ourselves with very very heavy expenditures. I think it would probably run to - - I made an estimate at one time, and I think it was somewhere in the neighborhood of \$100 million; but I don't think you would get any corresponding benefits from it. The narrow gauge railway is doing a good useful piece of work in Newfoundland. I think the case might have been different under other circumstances, but the narrow gauge railway being located there, being built where it is, I think it is economic to continue it as a narrow gauge railway.

Q. And the Canadian National will, of course, give consideration to the additional operating expenses that are incurred by virtue of having this one narrow gauge system, and you will weigh those advantages against the

disadvantages?

A. Quite.

Q. You said this morning, I think, that the expenditures required would be quite substantial. You said also that they had made no exact estimate. Have you made an estimate?

THE CHAIRMAN: That is for terminals?

MR. COVERT: Yes, terminals, and he said that they had to renew all rails, and have new ships and so on.

Q. I was wondering if they had made any rough estimate at all, Mr. Fairweather.

A. I know that it would be a matter that would be measured over a ten year period; it would be measured in tens of millions, but I would not care to go any farther on it.

Q. The next matter I want to discuss with you, Mr. Fairweather, is the question of the comparison of the density maps of the Canadian Pacific and Canadian National. My recollection is that you show somewhere in the neighbourhood of about the same percentage of red lines, approximately 24%, and the yellow lines; the Canadian Pacific show about 29%, and I think yours is about 30%. In the green lines I think your percentage is - -

THE CHAIRMAN: Pardon me.

Q. Before we leave the question of Newfoundland, this is another case of an entrusted railway?

A. Yes, sir.

Q. We have not heard yet, so far as I am aware, whether or not there is any line drawn in the case of these entrusted railways as to expenditures. They are entrusted to your company, as I understand, for management and operation?

A. Yes.

Q. But by the way you deal with them it would seem that all expenses concerned with capital and other are thrown on the railway?

A. Yes, that is right.

Q. There is no line drawn between where the owners of the railway should provide and what you on the other hand should provide?

A. No, there is not. We drew attention to that in Mr. Cooper's presentation and in Mr. Gordon's statement, in regard to the capital expenditures on the Canadian Government Railways. You might have thought that it would be logical for the railway to say to the Government, "Now we have to build a new station on your property; it is going to cost \$35,000; you supply the \$35,000 to us to build that new station." That is not the way it works.

Q. Has that sort of proposal ever been discussed with the Government?

A. Oh yes, and the Government has seen fit to take the view that in entrusting the property to the Canadian National that it is the Canadian National's job to administer that property, incorporate its results in the consolidated income account, and present the consolidated income account to the Government; then if there is a deficit, the deficit is voted by Parliament. But at the time the Newfoundland - -

Q. Would it make any difference to you whether that system were changed?

A. It is debatable. I was going to say that at the time the Newfoundland railways were being considered, the Canadian National Railways made representations that the Newfoundland Railways be treated on the same basis as the Hudson Bay Railway; it was considered by the Government,

and the Government decided that it wanted the Newfoundland Railways entrusted to us in the same manner as the Canadian Government Railways, and not in the manner of the Hudson Bay Railway. The reasons that the Government made that decision are unknown to me, but they made the decision. Then we pointed out that the operations in Newfoundland were very special, and we requested permission and were granted permission to lay the case before this Commission. It was suggested, as a matter of fact, that we do lay the particular problem before the Commission, and we have laid it before the Commission in a form of what we call negative capital. We say if you give us relief of \$134 million we are willing to operate the Newfoundland Railway and take our chances.

Q. Tell me this, insofar as the Hudson Bay Railway is concerned, is your company satisfied now with the present arrangement?

A. We are eminently satisfied with it, yes.

Q. You are?

A. Yes.

Q. And you do not see why there might not be a similar arrangement about the Newfoundland Railways?

A. That was the Canadian National's original idea.

Q. What about any other railways that have been entrusted to you?

A. Well, there is the Temiscouata Railway.

Q. It seems to me there is a considerable stretch of the meaning of the word "entrusted"?

A. I suppose there is. The Canadian National Railways, after all, was brought into being as an instrument

for doing this sort of thing.

Q. May I put to you the other side of the picture, as to whether or not you are content to do all that sort of thing and not complain about it?

A. I imagine that is probably what - -

Q. That may be the reason why you were created?

A. But you could hardly expect us not to complain, human nature being what it is.

COMMISSIONER ANGUS: Q. There isn't any burden in the case of the high density lines?

A. No, there is no burden there, but unfortunately we have a super abundance of the other kind.

THE CHAIRMAN: Q. The high density line is what you call your own line?

A. Yes.

Q. The thick part of it - you call that your core?

A. There is a core, yes. We have these fringe lines, and I think it is true that the greater proportion of the fringe lines are found in the Canadian Government Railway group, than there would be in the balance of the system.

COMMISSIONER INNIS: Q. Would the Government be more sensitive to pleas for capital for entrusted lines than it would be for other lines?

A. You mean actually?

Q. Yes.

A. No, there is no difference at all. So far as the managerial function is concerned, once these lines are entrusted to us they are treated exactly the same as if we owned them.

Q. As far as you are concerned, but what about as far as the Government is concerned?

A. And as far as the Government is concerned, as far as I know.

Q. If the people in Newfoundland begin to complain bitterly, from a political standpoint, you wouldn't be in any better position for getting capital, than any other part of the railway?

A. They might complain; I don't know what the results would be. I can only speak from experience. Experience to date is that we do not discriminate at all with capital or operation as between these entrusted lines, nor anything else - - at least, not to my knowledge.

Q. Do you mean discriminate or distinguish?

A. Discriminate or distinguish, in the dictionary sense.....

Q. I think there is a difference.

A. There may be.

MR. O'DONNELL: The practical results are the same.

MR. COVERT: Is your lordship through questioning?

THE CHAIRMAN: Yes.

MR. COVERT: Q. I was dealing with the two density maps, that is the density map filed by the Canadian Pacific and the map filed by the Canadian National. I have pointed out the similarity of the percentages of the three types of lines, the green, yellow and red. It has been suggested that the Canadian Pacific has a large group of poorer lines in ^{the} Crow's Nest territory; in addition to those of low density they also have what are alleged to be sub-normal rates. Could you give us a comparison with regard to the Canadian National in that respect?

A. I know that in any large railway system you will find a somewhat similar pattern of thin traffic density lines, but what makes the Canadian National special, is that the over-all traffic density of the Canadian National is 10% lower than that of the Canadian Pacific; consequently the Canadian National's ability to stand these thin traffic losses is less. I have already explained the very great importance of traffic densities as determining the net revenue of a railway; it is the very first mark. Now, it is true that if you take and group the lines of the Canadian National and the Canadian Pacific Railways by relative traffic densities you will find the percentage arrangements of the lines in the two systems approximate each other; but suppose you say to the Canadian National Railways: produce a system of the same traffic density as the average traffic density of the Canadian Pacific by lopping off the thin traffic branch lines, you would then find the Canadian National would have to lop off no less than 2383 miles of thin traffic branch lines to bring its traffic density up to the average traffic density of the Canadian Pacific. Now, I do maintain that that was very clearly shown, that this thin traffic branch line problem is much more serious to the Canadian National than to other railways.

THE CHAIRMAN: Q. Would you tell me whether this entrenchment of 2300 miles would be all entrusted lines?

A. Oh, no.

Q. Some of it would be your own?

A. Some of it would be Canadian National Company lines, some of it would be Grand Trunk Pacific, some Canadian

Northern, and some of it would be Canadian Government Railways; but it adds up to 2383 miles that would have to be lopped off the Canadian National System, of thin traffic lines, to bring the average traffic density up to that of the Canadian Pacific.

MR. COVERT: Q. Now, Mr. Fairweather, the Canadian National does not suggest that there should be a separation of the lines in such a manner that the two roads could be made comparable, does it?

A. A separation of the lines?

Q. Yes. For instance, you do not suggest that one of the remedies would be, for example, taking the Newfoundland Railway and the Temiscouata Railway out of the system altogether?

A. We have made ^{such} no/suggestion.

Q. And you do not think that that would be a more proper way of doing that, taking these lines that are non-paying, and which look as if they may be non-paying for a long time, out altogether from your system accounts, rather than approaching it from a recapitalization aspect?

A. Well, it is a matter of broad policy, and ^{the}Chairman has already touched upon it. I can see arguments for it and against it; and we have actually in the Canadian National system examples of both treatments. That is, we have the entrustment in toto and the entrustment as an agency.

Q. That is the Hudson Bay?

A. The Hudson Bay Railway. We try in each case to furnish as prudent and as careful management as it is possible to furnish, but I don't know that I would want to answer. I think that we have in the consolidated

accounts of the Canadian National Railways the advantages of simplification. I think that is one thing in favour of the entrustment argument, perhaps adjusted as we have suggested by some compensating off-sets; because once you start separating the property into pieces you can only do it with accounting. You see, if you are going to be efficient in your operations you have got to treat it as an entity. For instance, if you had the Temiscouata Railway entrusted to us on an agency basis, and if we were going to be efficient in our operations, we would not look upon it as an agency; we would look upon it as an integral part of the system. Then we would have to set up an accounting procedure to keep the accounts, and you would be mixed up with pro-rates.

THE CHAIRMAN: Q. What is that?

A. Pro-rates. It is the technical jargon for dividing expenses when you can't - -

MR. O'DONNELL: An arbitrary division.

THE WITNESS: An arbitrary division, when you don't know how to divide them.

THE CHAIRMAN: Q. A new monster?

A. Yes, a new monster. If you approach the problem from that angle you would in effect be trying to allocate by an accounting procedure the disabilities currently, as they occur; whereas, the other^{way}/of approaching it, you lump them all in and then try to evaluate the disability and say, give us relief in the large - -

Q. In the case of the Hudson Bay Railway you do have agency accounting?

A. In the case of Hudson Bay we have agency accounting.

Q. I presume it would be easier there on account of the location and the nature of the lines?

A. That is the sole justification, in my opinion, for segregating them. It is off by itself; it is operated on a very skimpy basis, and it is easy in that case to segregate the accounts.

Q. At this point you might tell me this: I have been anxious all along to ascertain from you what you call the core of your system. We have it now; you have given it to us, and the map shows it.... That is the word Mr. O'Donnell used this morning?

A. Yes.

Q. Can you tell me whether that part of your system, the core of the Canadian National system, is profitable in itself?

A. Oh, yes.

COMMISSIONER INNIS: Q. That has been changed, I presume the old Grand Trunk was not profitable?

A. The old Grand Trunk wasn't profitable consistently, no; and when it got together with Grand Trunk Pacific it went bankrupt; but the Grand Trunk Railway with its network of lines strategically located in the industrial part of the country, benefitted greatly from the consolidation of the property. So that we feed into that system a great deal that otherwise would not exist. I would not say that the Grand Trunk of the pre-acquisition days can be compared with the Canadian National Railway Company today as an earning property.

Q. That is the point I want to bring out: it makes a difference.

A. It makes a big difference.

MR. COVERT: Q. There is one further point I want to deal with, and perhaps it can be dealt with very shortly.

That is with respect to the Crow's Nest rates. Now, the position of the Canadian National Railway as set out at page 191 of the Brief, ends with this last sentence:

"It considers that there is some merit to the suggestion that all rates should be placed under the jurisdiction of the Board of Transport Commissioners".

The first thing I want to find out Mr. Fairweather, is whether your research department has made any study similar to that of the Canadian Pacific with respect to the Crow's Nest rates?

A. Oh, yes, we have studies of the Crow's Nest rates and many other things.

THE CHAIRMAN: What page do you refer to?

MR. COVERT: Page 191, Mr. Chairman.

THE CHAIRMAN: I have the wrong Brief.

MR. COVERT: Q. Have you made studies of the compensatory nature of the rates?

A. Well, now, you are getting into a field that, frankly, I find a bit baffling. I said earlier that every freight rate in Canada is inter-related, and the justification for a particular rate must be looked at in relation to its developmental possibilities and its productivity. If it appears to be below average cost, then some other related rate picks up the difference. So that when you analyze the Crow's Nest pass rates by themselves in my opinion you tend to get into the same sort of position of picking and choosing that you find the truckers get into when they pick and choose, or when shippers pick and choose, from the related rate structure, only the rates which they find desirable.

The Crow's Nest Pass rates are part and parcel of the whole related rate structure of Canada and they are part

and parcel of the warp and woof of the productive economy of the country. If you look at them by themselves you get a certain picture in relation to cost, but it defies analysis in my opinion as to whether or not the productive stimulus that there may be in the Crow's Nest rates are justified or not. That is not my function; let us say that other and higher authorities have defined that; it is incorporated in the Statute.

Q. All I have asked you, Mr. Fairweather, is whether or not you have made a study?

A. And I said, yes, I have made a study.

Q. Of that kind?

A. Yes.

Q. As to whether or not they were compensatory?

A. Just along the lines I have answered.

Q. What you mean is that you have not made a study of them by themselves, but your study has been in considering them with others?

A. I have compared them with other scales of rates, and undoubtedly they are lower.

THE CHAIRMAN: Q. I suppose you have read the study made by the Canadian Pacific?

A. Partly, yes, sir.

Q. You have read only part of it?

A. Only part, yes. I did not make a thorough study of it, sir.

COMMISSIONER INNIS: Q. Have you read the Alberta Brief on the location of industry?

A. Yes, I went through that.

Q. Have you any comment to make on it?

A. No.

MR. O'DONNELL: I think, my lord, Mr. Fairweather is being asked a lot of questions on which he has not the information. We have made no submission concerning the Crow's Nest rates, and he did not go into that. He had plenty of homework besides that.

THE WITNESS: Yes, I certainly had.

(Page 20157 follows)

MR COVERT: Q. Now, I wanted to ask you this, Mr. Fairweather: Does the Canadian National regard the Crow's Nest rates as a serious problem as far as they are concerned?

A. Well, I think I have answered that. The whole rate structure---

Q. Would you answer me again?

A. The whole rate structure is inter-related.

THE CHAIRMAN: Q. That is, you cannot take these particular rates in themselves and tell us whether or not they are non-compensatory or---

A. I could analyze the rates, and have analyzed those individual rates in relation to the cost of service, but I have done the same with hundreds and hundreds of other rates. I do that all the time for the benefit of the Traffic Department, and we very frequently report to the Traffic Department that this rate falls far below the average cost.

MR COVERT: Q. Do you say that occurs often with individual rates?

A. Oh, yes, lots of commodity rates.

Q. Could you give us some examples, Mr. Fairweather?

A. Certainly. Take the iron ore moving from Atikokan to the head of the lakes -- take pulpwood -- we move pulpwood from away up on the Hudson Bay Railway down to points in Minnesota, and we move it at costs per ton mile very low indeed. We move iron pyrites concentrates from the mining area up in northern Quebec to markets down in the United States at rates that are very low indeed.

THE CHAIRMAN: Q. Would you say those rates just referred to are so low that they violate the rule given to us by the Canadian Pacific Railway regarding competitive rates -- that is to say, that they must always pay all the out-of-

pocket costs and something in addition by way of compensation?

A. Well, any rate that I have ever recommended has always met the test that it at least pays back the out-of-pocket cost.

Q. At least that?

A. I have examined rates, though---

Q. I beg your pardon?

A. I have examined rates that did not meet that test.

Q. Which are in effect now?

A. I would not be surprised to find some of them in effect.

Q. Well, you have mentioned a lot of rates just now.

A. For instance, the sand and gravel rate over long distances might conceivably be in that category.

Q. These other rates that you have referred to just a minute ago, are they what you would call non-compensatory?

A. Well, offhand I cannot recall any that is in effect now that would fall into that category, but they come very close to it.

THE CHAIRMAN: Well, we will have to adjourn.

---The Commission adjourned at 4:53 p.m., to meet again at 10:30 a.m. on Thursday, April 20, 1950.

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ROYAL COMMISSION
ON
TRANSPORTATION

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ROYAL COMMISSION ON TRANSPORTATION

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO,
THURSDAY,
APRIL 20th, 1950

THE HONOURABLE W.F.A.TURGEON, K.C. LL.D.- Chairman

HAROLD ADAMS INNIS - Commissioner

HENRY FORBES ANGUS - Commissioner

- - - -

G. R. Hunter,
Secretary

P.L.Belcourt,
Asst.Secretary.

- - - - -

COUNSEL APPEARING:

F.M.Covert, K.C.	}	Royal Commission on Transportation
G.C.Desmarais, K.C.		
H. E. O'Donnell, K.C.	}	Canadian National Railways
N.J.MacMillan		
H.C.Friel, K.C.		
C.F.H.Carson, K.C.	}	Canadian Pacific Railway
F.C.S.Evans, K.C.		
I.D.Sinclair		
C.W.Brazier	)	Province of British Columbia
J.J.Frawley, K.C.	)	Province of Alberta
M.A.MacPherson, K.C.	)	Province of Saskatchewan
C.D.Shepard,	)	Province of Manitoba
J. Paul Barry	)	Province of New Brunswick
Frank D.Smith, K.C.	)	Province of Nova Scotia
F.R.Hume,	}	Canadian Automotive Transp o portation Association
M.L.Rapoport		

- - - - -

Ottawa, Ontario
Thursday, April 20, 1950.

M O R N I N G S E S S I O N

S. W. FAIRWEATHER - Recalled

EXAMINED BY MR. COVERT:-

Q. Mr. Fairweather, yesterday afternoon we were discussing the question of rates in perhaps what you call the low yield category, and I think you mentioned such things as iron ore, pulpwood and iron pyrites, concentrates, and so on, and also sand and gravel. I wanted to first find out this. When you make studies of particular rates to find out whether or not they are compensatory, do you do something more than apply these so-called usual tests of earnings per car mile and per ton mile?

A. I think, sir, we ought to first define what you mean by "compensatory". In my mind at least there is a difference between the definition of a compensatory rate and whether or not it meets the test of paying its out-of-pocket expense. I think there is a difference.

Q. All right; let us have it.

A. If we are talking of out-of-pocket cost itself, my department has over the years developed a most elaborate costing system, and by means of that costing system we do advise the traffic department as to whether or not, in our judgment, the rate in question will return enough revenue to meet the out-of-pocket expenses incurred. Then the traffic department takes that into consideration, and no doubt it is one of the factors that controls their decision; but I do not know that it is the sole determinant.

Q. Could we just explore that matter a little bit. You say "the out-of-pocket expenses incurred". Could you tell me just what you mean by that?

A. I am afraid if I told you just what I meant by that

I would be here for a long, long while. It is a branch of cost accounting or cost analysis that I refer to, which deals or attempts to deal scientifically with the analysis of railway costs. The factors that are taken into account vary with every particular case. You cannot make any generalized formula or at least we have never been able to make any generalized formula. But we do apply this principle, and it is a rather simple one in principle; but to apply it requires a great deal of skill and a great deal of knowledge of the detail of railway operation. The test is simply this. First, you assume that your traffic is moving and you determine your cost components. Then you test the accuracy of your analysis by assuming that the traffic does not move, and determine to what extent expenses can be reduced, by subtracting the traffic in question. I do not know that I can be any more precise.

THE CHAIRMAN: Q. Would you please repeat that for my benefit?

A. The test is whether or not the movement of this traffic will add expense and to what extent it adds expense. We test it by determining to what extent expense would be reduced if the traffic did not move. It is a very tricky subject; and if one gets into the detail of it you can quote ^{instances} where the cost of moving an individual shipment is almost nothing. I could give an illustration, for instance, where you were moving traffic against the current of traffic in which your locomotive miles and your car miles are in no sense influenced by the traffic you propose to move. You, let us say, have a predominating movement eastbound; and a new piece of business comes to you westbound. Your added costs in that case are very little. In that specific instance you would not be able to determine perhaps so much as one cent of additional cost.

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But ~~one~~ dare not approach this question of cost analysis without a proper appreciation of the law of probabilities. You have to recognize that you are dealing with a whole multitude of individual happenings. Some of them will happen under one set of circumstances. Some will happen under another set of circumstances. You have to deal with the most probable result, so that your estimate, when you finally produce it, is really a problem in probabilities. You say: "This is the background against which the traffic will likely move, and it will likely move in this pattern; and therefore it is most probable that the expense apportioned to that movement will be this figure."

We always advise our traffic department, when they get these figures from us, that they must be used with a great deal of caution; and we also insist, before we make a cost analysis, that we know precisely, or as precisely as possible, the nature of the movement and everything surrounding it. It is, in fact, an attempt at scientific cost analysis.

MR. COVERT: Q. That is, in determining what you call out-of-pocket expense you take additional traffic or you decide whether or not you lose traffic, is that right, or whether you will abandon traffic?

A. No. I say it is only one factor in that. It throws light on the problem to the extent that a cost analysis can throw light on the problem. I did not say that it was the determinant. There may be very good and valid reasons why the rate may be put into effect or not put into effect.

Q. You mean even if it showed that they would not cover out-of-pocket expense in this test?

A. Yes.

Q. Could you give us some examples of that, Mr. Fairweather, to show where you might have a case where

it was indicated that out-of-pocket expenses would not be recovered?

A. If we are talking in general, I think I have already illustrated that development branch lines fall broadly into that category, the whole traffic moving to them over a long period of time. But if you are dealing with specific examples --

Q. Yes, I would rather do so. Your development branch lines are something that you are taking the long view on. Is that right ?

A. That is quite correct.

Q. I should like to take some specific examples.

A. Let us take some specific examples then. I quoted yesterday an example of a rate on iron pyrites.

THE CHAIRMAN: Q. A rate on what?

A. Iron pyrites.

Q. Yes?

A. Moving from a mine in Northern Quebec for export. That rate, when tested by us, was found not to yield sufficient revenues to pay out of pocket expenses. Nevertheless it was considered sound and prudent, in the national economy and in the broad benefit of the Canadian National Railways, that that rate be put into effect. Another instance is this. Let us take the rates on the movement of basic commodities to the Atlantic ports of Canada, to Saint John and Halifax. Take grain moving on export rates to Saint John and Halifax where I believe the extra rate over Montreal is only one cent. One cent a bushel is obviously not sufficient to pay the added expense.

Q. Is that one cent a bushel or one cent a hundredweight?

A. One cent a hundredweight, yes; I stand corrected. That is obviously not enough to pay the out-of-pocket expenses incurred in an eastbound movement because it is moving in the direction of traffic and it manufactures

1. The first part of the paper is devoted to a general discussion of the problem of the existence of solutions of the system of equations

$$\frac{dx}{dt} = A(x)u, \quad \frac{dy}{dt} = B(y)v,$$

where $A(x)$ and $B(y)$ are matrices depending on x and y respectively, and u and v are control functions. It is shown that under certain conditions the system has a solution.

2. In the second part of the paper the problem of the existence of solutions of the system of equations

$$\frac{dx}{dt} = A(x)u, \quad \frac{dy}{dt} = B(y)v,$$

is considered, where $A(x)$ and $B(y)$ are matrices depending on x and y respectively, and u and v are control functions. It is shown that under certain conditions the system has a solution.

3. In the third part of the paper the problem of the existence of solutions of the system of equations

$$\frac{dx}{dt} = A(x)u, \quad \frac{dy}{dt} = B(y)v,$$

is considered, where $A(x)$ and $B(y)$ are matrices depending on x and y respectively, and u and v are control functions. It is shown that under certain conditions the system has a solution.

4. In the fourth part of the paper the problem of the existence of solutions of the system of equations

$$\frac{dx}{dt} = A(x)u, \quad \frac{dy}{dt} = B(y)v,$$

is considered, where $A(x)$ and $B(y)$ are matrices depending on x and y respectively, and u and v are control functions. It is shown that under certain conditions the system has a solution.

5. In the fifth part of the paper the problem of the existence of solutions of the system of equations

is considered, where $A(x)$ and $B(y)$ are matrices depending on x and y respectively, and u and v are control functions. It is shown that under certain conditions the system has a solution.

car miles and ton miles.

Q. That is to meet the competition of the American ports?

A. That is to meet the competition of the American ports; and the railways -- at least the Canadian National Railway carries the traffic at that base, although I have advised that the revenue you get from that rate is not sufficient to pay expenses.

Q. You are talking then of the haul between Montreal and Saint John and Halifax, are you?

A. I am talking of the haul between Montreal and Halifax and Saint John.

Q. Does it not mean this to you; by giving them
a low rate farther on, you do get the traffic up to Montreal?

(Page 20166 follows)

A. Yes, and frequently when you test that in its over-all movement you still find the same condition. That is, if you take the rate from point of origin to Halifax in two pieces and apply it to the total movement, and you still find that it will not meet that test, but, as I said before, out-of-pocket costs are not in themselves a determinant. They are, as I see it, a very useful tool to aid management in reaching a decision. They know what they are doing, they do the thing with their eyes open and they know what is involved, and they balance the benefits against the disabilities and make their decision on that basis.

Q. What would happen, I mean now to your railway, in the way of benefit or loss, if you did not have these cheap export rates?

A. Well, I think, sir, that that opens a tremendously wide field.

Q. I am talking only of your railway, though.

A. Well, I say even as---

Q. Not the national concern.

A. But I am talking also just of the Canadian National Railway, because the Canadian National Railway can only secure revenue if the country itself is prosperous and is producing, and so long as there was a functional monopoly of railway rates, and you were sure in the sum total of your rate structure of getting enough revenues to meet your expenses, you had a very wide freedom in how you would apportion those costs between different shippers, and it might very well be prudent to ship low-grade commodities or any commodity at a very low rate if thereby you stimulated development and took your profits in the form of higher rates on secondary production. That has been the basis in fact, as I see it, under which Canada developed, and it also

brings very forcibly to attention the condition that is now created when that functional monopoly has been impaired in the location where most of the net revenue came from. We get two thirds of our net revenue from about one third of our traffic.

MR COVERT: Q. Have you any other examples in mind of the same thing?

A. Well, it sometimes happens that you will have rates on these low-grade commodities moving from development areas that fail to meet this out-of-pocket cost test. I think I have given enough examples to illustrate the point. These things could go on and on and on. Generally speaking, you will find this condition in the movement of primary products very long distances to markets, where the railway is straining every effort to make a market outlet for a marginal producer -- some fellow who has got an idea or who has got a natural resource and he is developing it, and he comes to the railway and he says, "Now, here, I have this proposition, and if you can only let me get my produce to market by giving me a favourable rate I will start an industry," and as Chief Development Officer of the Canadian National Railways I am very much alive to the importance of transportation to the marginal producer in the development areas.

Q. Now, I wanted to get your views on these other tests that are applied, if you apply them to rates generally whether or not they are a fair test, and that is the revenue per car mile and revenue per ton mile, whether you think that that is a fair test as to whether or not a rate is yielding what it should to the railway?

A. Well, I can only answer this, that we have developed skills in costing analysis, and we apply those skills to the particular conditions that are set forth. We

cannot say categorically that a revenue per car mile or a revenue per ton mile in itself is a criterion. You have to have knowledge of all the circumstances under which the traffic moves.

Q. I am asking you, Mr. Fairweather, whether they are fair tests?

A. Well, I think I have answered you, sir. They would be fair tests in certain circumstances.

Q. In certain circumstances?

A. Yes, but they might not be in others.

Q. For instance, in determining whether or not a competitive rate should be put in, are they fair tests?

A. You mean a competitive rate in what sense?

Q. Well, let us say, for example, trucks begin to take certain business away from Montreal to Toronto?

A. Well, I never knew of a competitive rate set to meet truck competition that was not remunerative to the railway. The reason for that is simple: Trucking costs certainly, even on an out-of-pocket basis, are certainly at least three or four cents a ton mile.

THE CHAIRMAN: Q. Are certainly what?

A. Three or four cents per ton per mile. Therefore the railway never needs to drop its rate more than to that competitive level. Now, at three and four cents per ton per mile on average traffic the railway cannot help but make a profit, so that when you quote a competitive rate against highway operators you are not running the risk of handling business uneconomically. What you are doing, however, is lopping or skimming off the cream of the rate that was previously in existence and which was used to support these other rates. That is the tragedy of the situation. But no competitive rate that I have ever examined set to meet truck competition was ever below or

anywhere near below the cost ^{of} service by rail.

MR COVERT: Q. Then I wanted to get that clear, Mr. Fairweather. What you say is that when it is complained that these low competitive rates are not compensatory to the railways, that just is not so?

. It simply is not so, in the sense that they do not meet the test of cost analysis. They will always meet that test. The other side of the picture I have already dealt with, that they---

Q. In other words, what you say is, you should be getting more on that business to make up for what you---

A. Yes. That is the really terrible problem, and in that sense, seeing that all rates are inter-related, this erosion of high-grade traffic is bound to have, in my opinion, unfortunate results in hampering the ability of the railway to extend low rates to basic commodities handled a long distance.

Q. I am interested also, Mr. Fairweather, when you mention that all rates are inter-related; I just want to clear that up a bit. Do you mean that when you are talking about the compensatory nature of rates, it means that the mass of rates as a whole, that is the way the railway looks at them to see whether or not they are proper and compensatory, rather than at individual rates?

A. Well, of course, you have to deal with rates on an individual basis, but even though they are dealt with on an individual basis they are undoubtedly inter-related, at least I do not see how anybody studying the problem can come to any other conclusion. An individual rate as applied to a railway is not primarily related to cost of service at all, and that to my mind must force the other inference or conclusion, that they must be inter-related if they are to produce in an over-all pattern the revenues needed to

supply the expenses.

Q. For instance, I think we had evidence before us, Mr. Fairweather, that there were certain rates that were regarded by the railways as non-compensatory, and I think it was used in the sense that they did not supply the cost, the out-of-pocket cost, plus something over and above?

A. Yes, I have already said that.

Q. Now, I think the ones that were suggested to us were these at and east grain rates, and the coal, and I think the grain rates. Now, do I understand that you have added something additional to that, for instance sand and gravel?

A. Well, I have simply given you instances where in my experience of examining into individual rates I have run across this condition. Now, I could not be any more specific than that. I just run across it. We---

Q. All I wanted to know is if you thought that sand and gravel was in the same category as coal and---

A. It is apt to be, but I would not say that all coal traffic failed to meet that test, not by any manner of means. We have a lot of coal traffic that we handle at revenues that are more than enough to meet out-of-pocket costs; we also have the same with sand and gravel; but I was referring to the chance that specific rates as applied to specific hauls of specific commodities do not invariably meet this test, and I have known instances where they do not; some of them I have mentioned.

Q. You see, there have been suggestions, Mr. Fairweather, that the Board should have far greater control over competitive rates, there have been suggestions that they should determine whether or not they are compensatory, and I think it has been suggested that the rules that would be adopted for the Board to make this determination are the

rules that the Board would use for determining the compensatory nature of a rate, these so-called yardsticks of ton mile and car mile earnings. Now, I wanted to find out if that is a feasible thing at all?

A. Personally, I think that the matter is much better left in the discretion of the railways. That would be my opinion.

Q. Well, that is one phase of the matter; that may be, but supposing that it is decided that that is not correct, all I am asking now is whether or not there are simple yardsticks that you can use to determine the compensatory nature of a rate for purposes of deciding whether or not it should be permitted, and I ask you if those so-called yardsticks are proper?

A. Well, I have been engaged in railway cost analysis now for thirty years, and the further I go into the subject the further I am convinced that there is no simple yardstick.

Q. Then you think that answers my question, do you?

A. I think it does.

Q. In other words, you may think you have answered it -- I am not suggesting you have not -- but I am not satisfied with the answer. I just wanted to know whether or not you would say that these two yardsticks could ordinarily be used for that purpose, and do you say no?

A. I would say that to use them in your sense of ordinary, I think would be highly dangerous. That is my opinion.

Q. Then the Board of Transport Commissioners would have to have available much more information and other tests than those?

A. If anybody wished to determine the probable result -- and I have stated that when you get your result

it is only a probability -- one needs to have access to detailed information which so far has only been available within the confines of the railway management. You have to have access to the vital and ever-changing pattern of railway performance, because, for instance, the reversal of the direction of traffic, just to give a simple illustration, will change the picture entirely.

(Page 20173 follows)

The allocation of a different type of locomotive to a particular territory changes the pattern; the availability of car supply changes the pattern. You have to be on top of the subject all the time if you are going to give a realistic answer. I do not deny that it might be possible to do it, but I will say this, that generalized analyses based upon system averages and things of that character, which are generally what is available at the present time to people outside the railway, are a very inadequate approach to cost accounting of railway performance.

Q. It seemed to me -- I noticed in the I.C.C. decisions that they did apply those tests, and I think there was one other test. They took the percentage of the ratio of ^{the} competitive rate to the non-competitive rate as another test, and it seemed to me that they used those tests quite frequently.

A. The Interstate Commerce Commission has to my knowledge developed costing data over the years, and a good deal of it is, in my opinion, very sound. We have used methods similar to theirs, but all I am saying is that these generalized approaches have limitations, and they are not necessarily the proper criterion, especially when you are dealing with such things as commodity rates and competitive rates in an ever-changing pattern of industrial activity of the country. You have to go finer into your problem than that if you are going to get a realistic answer.

COMMISSIONER ANGUS: Q. When you say it must be left to the railways you are leaving to them both the technical problem and, as I understand it, some sort of economic planning as to what will promote the general prosperity of the country and maintain their revenues over the period.

A. Well, modified as that might be by regulation and possibly by statute, I think that is true.

COMMISSIONER INNIS: Q. Are you checked at all by the work done by the Canadian Pacific, for example, on the whole field of railway rates? That is to say, if Mr. Jefferson permits a rate on a certain commodity in a certain territory you are pretty well compelled to meet that?

A. Oh, yes, there is no doubt that the two railways are faced with that problem, the two major railways of Canada, and not only that; they are faced with the same situation in international traffic where they are always up against the matter of United States competition.

Q. Does that mean that you generally come out at about the same place?

A. Of course, this matter of detailed rate making does not fall into my province, but it is obvious that the competitive rates must be at the same level. The only place for independent action is in the non-competitive rate.

Q. Mr. Jefferson said something about using a year as the limit for developmental rates, that if a developmental rate did not show promise of covering all the various items within a year then it would not be accepted. Your view would be more flexible?

A. Yes. Of course, one thing you have to be careful about when you put a development rate in, it seems to me, is that the person who is the recipient should thoroughly understand that it is in the nature of a temporary arrangement, but once he thoroughly understands that I think that the rate and the conditions of the rate should be as flexible as possible to develop the true potentialities of what is in hand. I would not want to put any arbitrary limit on the thing although I

can understand a traffic man desiring to shoot at one year as a reasonable pattern, but I can think of developments where such a rate certainly would not induce development.

MR. COVERT: Q. There is just one question I want to come back to, Mr. Fairweather. On page 14 of Mr. Gordon's brief he was dealing with the revision of the capital structure and he said:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital."

He goes on to say:

"However, in view of the practical difficulty in the way of converting the interest-bearing capital in the hands of the public into equity capital at this time; and having regard to the potential earnings of the Canadian National System, which are considerable and may in some degree offset the adverse factors here considered", and so on.

THE CHAIRMAN: Is that Mr. Gordon's brief?

MR. COVERT: Yes.

THE CHAIRMAN: What page?

MR. COVERT: Page 14.

Q. All I want to know, Mr. Fairweather, is whether you feel that the entire interest-bearing capital should be converted into equity capital, that is, to do a proper job, a real job, that should be done?

A. No, I do not think that is exactly what is stated.

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital."

Q. The difficulty is that they are in the hands of the public?

A. Now, there is no doubt that if the Canadian National Railways was operating as a private concern that the amount of interest-bearing capital that it could bear with security and maintain a credit standing is very small and might, as is stated here, be zero.

THE CHAIRMAN: Q. Be zero?

A. Yes, because the Canadian National Railways unfortunately is a low-traffic density line. Our revenue per mile, notwithstanding the heavy industrialized sections of our line, when you average it out over the whole system I think it is about \$19,000 per mile, and to operate a railway and give service under those conditions with that level of revenues creates a very severe problem indeed.

I stated that the operating ratio, which is a rough test of how much earnings will be available to meet charges other than straight operating, is at the present time set by a formula of 8,270 divided by the revenue per mile, and to that fraction another fraction of .54 should be added. That means that the operating ratio of the Canadian National Railways in 1948, I think, was away up in the nineties. It is obvious that it does not leave very much leeway. Then if you are in that position in a period when traffic is of high volume, and you are faced with the down swing of a business cycle, and if you realize that the rate of change of the operating ratio is inversely proportional to the square of the density of traffic you can see how serious a condition you can get into with a road of basically low traffic density.

We have very little cushion between a prosperous operation and one that is a deficit operation, quite apart from this matter of fixed charges. It is an inherent characteristic of the Canadian National Railways, and it is an inherent characteristic of any low-traffic density

line. If we had, for instance, an average traffic density ten per cent higher than our present traffic density we could stand a very substantial amount of fixed charges with a degree of confidence, always supposing that we get this highway competition thing fixed up, and that there was not further erosion of net from that quarter. With a basically low-traffic density that can only produce \$19,000 of revenue per mile under conditions that if they are not boom are at least a very high level of activity, and having regard to the past swings and the business cycles we have seen in the past, I do not think any prudent man could say confidently that the Canadian National Railways might not at some time in the future, and within the foreseeable future, find itself in the position that it had no returns available to meet fixed charges.

I do not like to look to it as a prospect. I would like to think these business depressions will not come, but history has sort of indicated that they are at least a probability. It is in that sense that this statement is made that judging by ordinary commercial standards, the entire interest-bearing capital should be converted into equity capital. On the other side there are the practical difficulties which I mentioned, and I will say this, that it is to be hoped that the Canadian National Railways will gradually work itself into a position where it has a cushion of increased partially density of traffic. That would come about by an increase in population, an increase in the productivity of the country and would, however, in my judgment be offset by the necessity of building further development lines in order to produce this increased productivity of the country. So that the future holds interesting possibilities, and we hope that on the whole it will

provide a cushion at some time in the future, but it is not there now, and in my opinion it is a very considerable time before it could arise. In the meantime you are up against this position, that the Canadian National income results are barometrically in nature, that is, they rise and fall with much more sensitivity to business conditions, the net earnings of the Canadian National, than would a railway of higher traffic density, just for the reason that I have stated, that variations in the operating ratio are inversely proportional to the square of the traffic density.

(Page 20180 follows)

MR. COVERT: Q. My point was this. I was wondering whether perhaps, Mr. Fairweather, you had really gone far enough in your proposals because the earlier pages indicate that you have been conservative in arriving at those figures. If, for example, we have reached a peak now -- I think the C.N.R. reached a peak in its total traffic last year -- and if things get worse, perhaps you have not gone far enough.

A. You may be right. But in my judgment this is a very appropriate challenge to the management to give us the fixed charges that we ask for and expect us to meet them.

I think it will conduce to efficient operation.

Q. That is all, I think.

THE CHAIRMAN: Is there anybody else who wants to ask Mr. Fairweather any questions?

MR. HUME: Yes; I should like to.

CROSS-EXAMINED BY MR. HUME:

Q. Mr. Fairweather, I represent the Canadian Automotive Transport Association and I should like to discuss with you one or two questions as a result of your evidence that was given yesterday which appears in volume 109 of the transcript. I am informed, Mr. Fairweather, that you have made a very long study of this highway-railway competition problem. Is that correct?

A. Yes, it is.

Q. Over how many years?

A. Let me see. We started in 1924. That, to my way of thinking, would be twenty-six years, would it not?

Q. So that, on behalf of the Canadian National Railways, you have carried on a series of studies on this problem for that length of time?

A. We have.

Q. There are one or two points I should like to clear up, or perhaps clarify before I discuss some of the aspects of that problem with you. One is this. At page 20115 of the transcript yesterday you referred to certain figures to which you had referred earlier, in answer to a question by my friend Mr. Covert, to the effect that the railways are carrying some 90 per cent of the goods, and you said that approximately 23 per cent of the revenue went to the trucks?

A. Yes.

Q. And you were asked "Is that correct?" and your answer was yes, that was correct. Do I understand that you are basing those figures as a result of studies made by the Railway Association of Canada in their submission?

A. Those figures are based upon studies that were made in my own department and which were made available to the Railway Association of Canada.

Q. And those figures and substantially those percentages appear in the submission of the Railway Association of Canada?

A. I believe so, yes.

Q. I wonder whether or not you are aware of the fact that in the subsequent cross-examination of the witness on behalf of the association we discussed the fact, as the brief did submit, that a very large percentage -- in the opinion of the witness, about half -- of the goods travelling over the highway movement were in shipper-owned vehicles?

A. Yes.

Q. And that this 23 per cent of the revenue which went to the trucks does not mean that 23 per cent is going to the commercial truckers.

A. I did not say so. But to my way of thinking, from the point of view of transportation economics, what difference does it make whether it is the commercial trucker or the

private trucker? It is all the same.

Q. No, but I suggest that you did say so on this page 20115, when you said that 23 percent of the revenue from transportation went to the trucks.

A. Certainly.

Q. If the John Jones Manufacturing Company is moving its own goods in its own vehicles, where is it receiving revenue from the movement of those goods?

A. It is receiving revenue in an economic sense equal to the value of the service that it is obtaining. What I was attempting to show was the effect upon the railway revenue of uneconomic truck competition; and the estimate is the estimate I gave. To me, as an economist, it would be silly to say that, because a man operates with his own vehicle between two plants owned by himself and carries his own goods, thereby there was not an economic effect; and it is the economic effect that I was talking about.

Q. So you are talking about the economic effect on the railway, and what you mean is that the railways are losing 23 per cent of the revenue that they previously had. Is that what you are saying?

A. What I am saying is that if highway competition was reduced to the economic sphere, there would be a transfer to railway revenues of a substantial amount, but not that 23 per cent.

Q. How much, then?

A. I think I would have to get the figures. That 23 per cent represents coverage of both economic and uneconomic .

Q. May I ask you this question. Have you made any studies which will assist us, assuming that the privately owned trucks were off the road for one reason or another, how much of that 23 per cent would go back to the railways?

A. I really could not say.

Q. May I put it this way. If the commercial for-hire trucker, the man who makes his money by transporting goods by truck were put off the road for one reason or another, how much of that 23 per cent would go back to the railways?

A. You mean if the private trucker still remains?

Q. Yes.

A. Well, I do not know.

Q. Do you agree with the Railway Association's estimate that about half of the over-the-road movement is by private truck and the other half by commercial truck?

A. I think that is approximately true, yes.

Q. That is on a volume basis.

A. It is on a dollar volume basis.

Q. So that I am correct, however, am I not, in saying that this 23 per cent figure includes goods moved, by a man in his own car or truck or any kind of transport he happens to own?

A. Yes.

Q. All right. That is fine. The next thing ^{is this.} that I thought might need clarification. / At page 20114 you were discussing what happened during the last war, and you said this:

"Therefore, by controls you prohibited the haulage of goods on the railway --

It means on the highway; that is a typographical error.

A. Yes.

Q. And you continue:

"-- and by so doing you increased traffic on the railways."

Then you went on to point out that this was done because you could not afford the manpower and material to be wasted by hauling on the highways. That by itself is correct, of course. But I wanted to clear up with you the fact that

you are probably aware that there was no control on the commercial trucker during the war.

A. I think there was very effective control on him. He could not get tires.

Q. But there was no regulatory control on the commercial trucker?

A. What would you need regulatory control on him for when he could not move?

A. Are you aware of the fact that in 1943, and that was during the war -- 1943 was during the war?

A. Yes.

Q. Are you aware of the fact that during that year the bureau of statistics estimated that commercial truckers moved over 11 million tons of freight in the one year?

A. That is quite true, yes.

Q. And that the administrator of services that same year estimated that the figure was nearer 21 million?

A. Well, I do not know.

Q. Assuming that it was so, may I suggest to you that there was no very serious restriction on the commercial trucker?

A. Oh, I think there was a most serious restriction on him.

Q. There was control on the private trucker, was there not?

A. I say that I am looking at the thing in its totality. I was talking of economic conditions. I refuse to make any distinction in the economics of highway transportation between the commercial trucker and the private trucker. So far as I am concerned, they are part and parcel of the same pattern and they have to be so treated. As a matter of fact, that is the basic reason why I have very little faith in regulatory measures addressed to highway operations; because so long as we maintain the right of the individual to haul his own goods on the highway in his own business, then any

regulation can be evaded. But that does not mean that the economic result is not there.

Q. The point I wanted to bring out for the purpose of the record was that there was a restriction on these private truckers of 35 miles from the city during the war; you are aware of that?

A I am aware of it generally, yes.

Q. And that so far as the commercial truckers were concerned, for reasons which probably were well considered at the time no restrictions were imposed other than as you point out, their inability to get tires; but somehow or other they seem to have managed to haul 11 million tons a year.

MR. O'DONNELL: There was gasoline restriction.

MR. HUME: Not on the commercial trucker.

Q. There was no gasoline restriction?

A. There was no gasoline restriction ;~~m~~ but he could not get tires and could not get vehicles.

Q. He seems to have been able to get some tires to be able to haul 11 million tons of freight in one year.

A. Quite so. But you must also remember that this is one of those things in which relativity has to be taken into account. The war created a tremendous volume of traffic; and the percentage of that traffic which was handled by rail versus what was handled by truck certainly changed during the war period, and it changed fundamentally for the reasons that I have stated. During the war we simply could not spare the manpower and the material to handle our transport with a more expensive medium than by rail; and the consequence was that it was to the railways that the burden of carrying the essential traffic of the country fell. I do not mean to say that there was not a useful field, even in war time, for the trucker. He fulfills a useful field. All I have

talked of there is the field in which he operated and is operating under an umbrella that creates artificial conditions for him, and as a result throws the development economy of the country into a state of stress.

Q. You used the phrase "uneconomic competition" on more than one occasion yesterday; and you applied it particularly to highway transportation and water transportation. What I wanted to ask you was whether or not you are prepared to carry it further and agree with me that air transportation is an uneconomic form of transportation, according to your interpretation of the phrase?

A. In certain of its aspects, yes.

Q. Let us take the aspect of moving passenger traffic. Would you say that was uneconomic?

A. I look upon air transport as a new medium of transportation which will have to find its position in the economy of the country. It is going through a development period. It certainly offers great advantages and it is basically an expensive medium of transportation. That some of its activities are subsidized by the state is undeniable; but I have not said anything on this stand to the effect that I was opposed to such subsidies.

Q. I am not suggesting that you did. What I want to see is whether or not you will agree with ^{this} If highway transport is uneconomic, according to your interpretation and also water transportation, as you mentioned yesterday, will you agree that air transportation is also uneconomic?

A. I think it is a matter of relativity again. It depends upon the extent of the side effects. I have no objection to somebody using a more expensive means of transportation if he thinks he gets value for it. But what I am saying is that when, in the process, he lays a burden on somebody else that is quite out of proportion to the

benefit he may get, then it becomes a matter of some concern.

Q. In the Canadian National Railways, do you figure that you make or lose money on your passenger traffic?

A. That is a moot question. I doubt, under modern conditions, if you take it all in all, whether the railway does much more, if it does that, than get a new dollar for an old one in passenger service. But the great bulk of our passenger service on the expense side is a matter of public convenience and necessity. With regard to many of these passenger services, the railways have to run them under board direction; and it is just because of such burden of public convenience and necessity which is laid upon the railway that one must necessarily look with rather alarm upon the erosion of the railway net revenue by uneconomic competition which denies the railway the revenues it had previously used to provide for these expensive and unremunerative passenger services along with others.

Q. So that if the air lines of the country build bigger planes and begin to carry more and more people, that will have an adverse effect upon the Canadian National Railways' passenger revenues?

A. It would certainly reduce passenger revenues to some extent. But then again you must take into consideration that the total travel habit will be increased, and it is quite conceivable that there would be a compensating effect. I cannot trace it through in all its details. But what I am saying is this. There is likely to remain for some time with the railway the problem of providing the necessities of traffic as measured by public convenience and necessity, quite apart from the profit motive. Certainly the Canadian National Railway operates thousands and thousands of passenger train miles which are unremunerative as measured by the yardstick of cost, and where you have

to carry on the operation, let us say, in the public interest.

Q. To get back to my question, then, you think that the movement of persons by air transport is a threat to the revenue position of the Canadian National Railway and therefore comes within your definition of uneconomic competition?

A. No. I did not say that it came within my definition of uneconomic competition.

Q. So that your objection is not uneconomic competition, according to the way you are using the phrase?

A. I would say that it has to be proven.

Q. All right. What about pipe lines? We are reading and hearing about the possible construction of gas and oil pipe lines to move gas and oil,^{of} which oil at least is carried, I presume, by the Canadian National Railways. Would that be uneconomic competition?

A. Oh, no. You must remember that I am a development officer; and if I see some medium of improving the economy of this country, and^{if} by that means the general wealth of the country can be increased, I am satisfied with the knowledge that somewhere in the cycle there will be a demand for railway services. The railways simply cannot compete in volume with pipe lines. The pipe line as to volume is a much cheaper medium of transportation of oil than the railway. consequently when you are dealing with very large mass movements of oil, the railway must of necessity bow gracefully out of the picture, in my judgment. They simply cannot compete. That is not a case at all parallel to this matter of highway and railway transport, because the conditions are exactly reversed. The pipe line is a cheaper means of transportation. Therefore, measured by basic economics, it should handle the business. The truck is the more

expensive medium, beyond a moderate zone, and therefore by that test, if that were the only test, the traffic should go by rail. I may say this to you. If the railways were free to use their competitive strength in this highway competitive zone, and were free to drop their rates down to a competitive level with the trucks, the trucks, beyond the zone where I admit they have an advantage, simply could not operate.

Q. Why are you not free? You can put in any competitive rate you want to over night, can you not

A. No. You see, railways are nation-wide in their scope. They have a responsibility to the country at large to handle all of the country's traffic in all its aspects. That problem being on their shoulders, if they used their competitive strength to drop competitive rates down to truck levels universally, under the present law, they would take off an enormous amount of their net revenue; and if they wished to remain solvent they would have to pass that on to the development area which of course would not be in the national interest. The plain fact of the thing is that therefore the trucker operating in what to him is a perfectly sound field of activity -- he operates in what to him is a competitive field, and I do not blame him for what he does -- says to himself, "I can handle this business cheaper than the rail rate. Therefore I am entitled to bid for it." But if that trucker for every ton of high-grade traffic that he moved between Montreal and Toronto, say had the obligation that he had to meet to move western grain for export from Canada or to move iron ore to the lakehead, he would very soon find out that his field of trade was very much restricted. He is a picker and chooser, under an artificial rate structure which was created for a specific purpose. It is that which I have pointed out, and nothing more.

Q. To get back, if I may, to the original question, may I ask you this. If the railways wished to, so far as the present state of the law and the regulations are concerned, they could put in a competitive rate, any competitive rate that they want to put in; but it is just as you point out, they feel that they should not do that sort of thing.

A. I feel it would be disastrous to the economy of the country if they did.

Q. But they are able to do it, in the ordinary meaning of the word "able", are they not?

A. To the extent that highway fields are competitive, I presume they have that power.

A. And in the past they have put in competitive rates at prices underneath the truck rates?

A. Oh, yes. I admit we have reduced our rates maybe by \$50 million dollars in the truck competitive area, to hold business; I mean \$50 million a year.

Q. Is it not an accurate statement to say that today truck rates and rail rates in eastern Canada are on a parity?

A. No, I would not say so.

THE CHAIRMAN: On what?

MR. HUME: On a parity.

THE WITNESS: No, I would not say that. They are only on a parity to the extent that the trucker desires to handle the traffic. If the traffic happens to be bulky, or if the traffic happens to be awkward, the trucker just puts in a prohibitive rate and that cost is handled at a loss. How much can you say there is parity under those conditions.

. I will begin with specific rates on specific commodities. Taking a specific commodity between Toronto and Montreal, I suggest to you that the truck rate and the rail rate are the same.

A. That may be, on a specific commodity. That is not strange to imagine.

Q. Do your studies indicate that they are the same today?

A. To some extent, yes; and to some extent, no.

Q. To what extent no?

A. I could not say specifically. I have already given instances. You take certain specific commodities, and you find that the rates are the same. I take certain specific commodities and found out there is a vast difference in the rates.

Q. Have you got one that you could give me?

A. I think I could. They have already been filed, I am informed, in the association brief.

Q. Taking the commodities upon which the rate is the same, do your studies indicate whether those things are still moving by truck?

A. Some of them are; some of them are not.

Q. In other words, Mr. Fairweather, what I am leading up to is this. In your discussion as I interpreted it, uneconomic competition, is based purely on a price or cost basis, and you ignore certain other factors in relation to shippers who use trucks such as flexibility, speed, less handling and things like that. Will you discuss that feature with me?

A. I think I have taken those into account. Necessarily a man under certain conditions may be prepared to pay a higher rate than he otherwise would.

Q. We are talking about commodities moving at the same rates. I preface my question by saying that. We will talk about other ones later on. Will you discuss with me those commodities. You say there are some that move between Toronto and Montreal at the same rate?

A. Yes.

Q. Some of them are going by truck and some by rail?

A. Yes.

Q. I wanted to ask you whether or not, in your discussion of the phrase "uneconomic competition" you did not ignore certain other features.

A. I say that is uneconomic competition.

(Page 20199 follows)

Q. If it is moving at the same rate?

A. For the reasons I have stated. Certainly I said it was uneconomic competition.

Q. Well, would you have that abolished or amended or changed in some way?

A. I certainly think something ought to be done about it. Just how that should be accomplished I do not know, but for the life of me I cannot see that this country can afford an erosion of its railway service to the extent that the highway is eroding them beyond the economic zone, and something ought to be done about it.

Q. All right. Now then, suppose I have a specific article in the city of Toronto and I want to move it to Montreal by the Canadian National Railway, how many times as a minimum would you say it would have to be handled, from my factory---

A. Are you talking about l.c.l.?

Q. I am talking about l.c.l. now, from my factory in Toronto to your store in Montreal.

A. It would be handled with a pick-up truck to the freight shed, it would then go by rail to a shed in Montreal, where it would be handled to a delivery truck, and that would be the sequence by rail.

Q. Now, supposing I wanted to ship that by truck---

MR O'DONNELL: I think that is already in the record in some detail.

MR HUME: It may be in the record.

Q. If I wanted to ship that same article by truck, it is possible, is it not, for me to have that handled only on the truck and off the truck?

A. Yes, but not usual, because---

Q. Well---

A. Just a minute. I think I am entitled to finish the

Mr. Fairweather, cr-ex.

answer. It is possible but not usual. When trucking first started of this nature that was the standard procedure, but truckers very quickly found out that they were up against identically the same problem in l.c.l. traffic that the Canadian National Railway and the Canadian Pacific Railway have -- that is, they had to have pick-up trucks of their own, bring it into freight depots, handle it in large vehicles over the road, and then break it down and distribute it again. You cannot imagine an l.c.l. shipment delivered in the city of Montreal from a truck trailer by individual peddler, and it would not be permitted, and the net result is that there is very little difference on the average. Now, it is just one of the necessary developments when you expand that particular type of traffic.

Q. Well, I suggest to you, Mr. Fairweather, that if you study the situation you will discover that what you say about the terminals and pick-up and delivery is true of some of the large operators in Eastern Canada, but by and large in the industry it is not so; is that not correct?

A. Always you will find the fringe operator who is operating very much on a small basis, and he will act as his own pick-up and delivery, and he carries his office under his hat, and that's that and that determines the level of his activities; but immediately he becomes a factor of any size in the transportation game he is up against this same subdivision of activity.

Q. And from your study do you have any idea as to what the percentage is between the operators who had these terminals and pick-up and delivery service and the other operators in the industry?

A. I have not at the moment, but I know that the tendency is very strongly in the long haul inter-city movements to the latter type. The little fellow cannot operate

in that zone. Mind you, I think you are forgetting that I allow the trucker a zone where he is economical, and that is a fairly substantial zone, and in that zone one of the main reasons for his being economical is the very point you raise.

Q. Now to get back then to my original point, about the handling, I am only mentioning that to illustrate something, and I am going to suggest to you that if I in Toronto wish to have my merchandise handled in the way I have described, is it uneconomical for me to go and pay whatever the toll is to move my goods over the highway?

A. No; you should be at perfect liberty to do what you like, but in making your choice some machinery should be invoked so that you would realize that when you did that particular thing it had side effects, because your choice of transportation by highway is a selection from a very highly complex rate structure by railway, and you as the shipper would be receiving benefits for which you were not paying, by reason of having available to you the portion of the rate structure for shipment by rail that you found desirable, and by reason of choosing some other form of transportation when you so desired. I have said that the rate structure, the railway rate structure, is all inter-related, and when a man enjoys an extremely low rate on a long haul shipment to reach a market, he enjoys it or has enjoyed it in the past because the railway somewhere else had levied part of that cost on some other traffic.

Q. I understand all that.

A. Yes.

Q. Now, you have agreed with me that if I wish to ship that merchandise by two handlings it is not uneconomic competition if I go out and hire a carrier to move it; you have agreed with me to that extent?

A. Within limits, yes.

Q. You say I should realize certain things about the economy of the rate structure, but, assuming all that, it is not uneconomic is that correct?

A. You are putting words in my mouth.

Q. Well, I am not intending to.

A. I said that there is a zone in which the transportation economy of this country is benefited by shipment by truck. I am only talking of that portion of the movement which is beyond that zone.

Q. Well, there is a considerable amount of movement beyond that zone, isn't there?

A. Yes; that is the unfortunate part of it.

Q. And shippers are willing to ship by truck even though it does not cost them less, because we have agreed that on some rates at least the price is the same?

A. Yes, but you are forgetting that the railway has reduced the rate structure by this \$50 million. That is something I could not just leave out of the picture.

Q. No, but when the---

A. That is very important.

Q. When the railways increased their competitive rates eastbound to the truck rates in Eastern Canada; do you know that?

A. Well, I presume that they would go up to a degree.

Q. They went up the same, didn't they?

A. I could not say that they went up---

Q. You do not know that?

A. No. I know they went up; whether they went up the same or not, whether they were uniformly applied or not, I do not know.

COMMISSIONER INNIS: Q. The \$50 million you mention is both railways?

A. That is my estimate, sir, of the amount by which the railways reduced freight rates to hold traffic to the railway.

Q. It is both?

A. Yes; that is the railways of Canada.

MR HUME: Q. And what period does that cover, Mr. Fairweather?

A. That would be applicable today.

Q. A year, though, is your figure?

A. Oh, yes, a year.

THE CHAIRMAN: Q. You say \$50 million a year?

A. \$50 million a year in rate reductions in truck competitive territory.

MR O'DONNELL: To hold traffic.

THE WITNESS: To hold traffic. There is a lot more we did not hold. There is \$60-odd million more---

THE CHAIRMAN: Q. When you say you did not hold, do you mean that you did not try to hold?

A. Oh, we tried to hold it, but, you see, the process of reducing rates to a point where we could hold it was too painful, and the judgment was that they had to let the traffic go rather than hold it by reduced rates.

MR HUME: Q. Well, am I correct in this, Mr. Fairweather -- in order that we can have the record as complete as possible on this thing -- my instructions are -- and you have studied this thing over many years, so you will be able to correct me -- that there is no price war between highway and railway competitive agencies in Canada today?

MR O'DONNELL: No what?

MR HUME: Q. Price war, where one undercuts, and then another undercuts, and then another undercuts, and there is a sort of spiral down the scale -- is there?

A. Well, I really do not know, but, knowing what I have found out about truck operations at various times when I examine it, I would not be surprised if there was something of the kind; and always we must remember this, that wherever an individual shipper has enough volume of traffic to handle his own goods in his own trucks he will set the level of charges by the cost of his operation.

Q. Do you mean by that that he will go to the railways and say, "If you don't give me such-and-such a rate I will put my own trucks on"? Is that what happens?

A. Yes, certainly; that has happened, and I have no doubt it happens to truckers too.

Q. As a matter of fact, I think, Mr. Fairweather, it was agreed here -- Mr. Jefferson gave some evidence that the agreed charges in Eastern Canada at least on petroleum and salt came about for that very reason?

A. Yes.

Q. There was not any truck competition on petroleum in Eastern Canada, was there?

A. Well, there was very definite prospect of it.

Q. By the shipper himself, though; isn't that correct?

A. Certainly.

Q. Yes. So that I suppose then you will agree with me, that the reason you stated yesterday that you do not believe that restrictive legislation or restrictive regulations will solve your problem, is because you have always had this ability of the private individual to buy his own transportation?

A. Yes, I have said that.

Q. Something he did not have forty years ago?

A. Yes.

Q. Then do you agree with the Railway Association in their submission where they go so far or went so far as to

suggest that even the private shipper had to be restricted in his own trucking?

A. Well, I do not know that they said restricted. I think what they said was that he had to be taken into account, and that if you attempted to deal with this highway problem without taking the private operator into account you would leave a loophole there that would destroy your attempted control.

Q. And do you believe that that is possible in Canada?

A. What is possible?

Q. The restriction of the private shipper?

A. Well, at least I think you can examine into the whole problem in all its implications and work out some -- you should be able to work out something that would permit the individual to make an intelligent decision as to how he wished to ship his goods, and where his own private incentive paralleled the good of the whole transportation economy. That is the real problem. At the present time it is out of whack. What is good for the transportation economy of the country is out of line with the incentive of the shipper, and again I want to make it very plain that no shipper faced with that decision can do anything other than he does.

Q. Well, at page 9297 of the transcript, at volume 48, according to my notes, Mr. Gaffney, a witness for the Railway Association, in interpreting their brief said that it was because of this fear that the shipper could buy his own fleet of trucks that the Railway Association stated that in their view you would have to control the private shipper, and there was some discussion.

A. It seems to me what you have to do is try and work out some sort of arrangement whereby you would approx-

imate to a free market position, so that individuals desiring to ship their goods by truck or by rail would be parallelling in their decision sound transportation economics; and if that is possible of achievement, then I think you could leave to the good sense of individuals and their normal competitive instincts the problem of adjusting the highway to the railway economy, and each would finally find its proper location. I have an inherent dislike of artificial conditions, with the necessity of policing them.

Q. Well, what I am trying to find out from you, Mr. Fairweather, is whether or not you go as far as the Railway Association witness in interpreting their brief, that it is because of this fear that the shipper can buy his own fleet that you feel that you have to control.-- I am using the word carefully, control -- the private truck. Now, either you believe that or you do not, one or the other?

A. Well, it depends on what you call control. I think I have made my position plain. I agree heartily that any attempt to deal with the situation as between railways and highways must necessarily take the private operator into account, and that is as far as I can go.

Q. You stated, I think, yesterday, and gave your reasons, that you do not believe in restrictive regulation or restrictive control, and all I want to do is to see whether the position of the Canadian National Railways, for whom you are speaking, is now somewhat different from the Railway Association, because in your brief you say you adopt their submission?

A. Well, it all depends on what you mean by control. What I meant was this: I do not believe that somebody should issue an edict and say that trucks should not be permitted to haul goods more let us say than 50 miles, that some board would decide that 50 miles or 75 miles or some

other mileage was the economic limit of truck carriage, and that therefore nobody should be permitted to truck more than 50 miles. I think that sort of restrictive legislation -- and it has been tried in various countries -- I do not agree with it. All I am saying is that here is a very substantial problem, it involves the national interest, and because it involves the national interest it should receive very, very careful consideration, and I have not got at the present time any clear-cut solution.

Q. You have been very close to this problem, as I know, for a great number of years, and may I suggest to you that the reason that you are unable to arrive at a clear-cut solution is that perhaps there is not one so long as you have the private individual potentially his own shipper?

A. No, I would not say that necessarily.

Q. Are you aware of the development in England recently where they have restricted the commercial trucker--

THE CHAIRMAN: I beg your pardon?

MR HUME: I asked Mr. Fairweather whether he was aware of the development in England recently -- I think it started February 1st -- where they have restricted the commercial trucker to a radius of 25 miles, I think it is.

THE CHAIRMAN: The commercial trucker?

MR HUME: Yes, Mr. Chairman.

Q. Are you aware of that development?

A. I have read what is going on over in England; I have read what is going on in France too.

Q. Well, let us talk about England first, and then you can talk about France afterwards. Are you aware also that the restrictions imposed on February 1st have not solved any problem, that there are just as many trucks travelling the highways?

A. Well, I think it only confirms what I have stated.

Q. So you will agree with me that that sort of thing is not any solution?

A. Well, I have stated that. In my direct evidence I stated that.

Q. And to that effect therefore the Canadian National Railways -- well, perhaps that is too wide. You at least do not agree with the submission of the Railway Association of Canada in that aspect?

A. No. I say it depends on what you call control.

Q. Well---

A. I do not think the Railway Association ever intended in their wording there to say that there should be controls of the nature that you are talking of.

Q. Well, at page 9298 the witness said that the sphere of control must be a mileage sphere; that is clear enough?

A. Well, yes, but the machinery of applying the control is the important thing, and that is what I am talking about.

Q. Now, Mr. Fairweather, at page 20122 you discussed the fact that co-ordination between railway transportation and truck transportation would lead in some cases to a better service to the public, and so on. May I ask you what has been done say over the last twenty years in your experience to sit down with the highway operators and try to work out some basis of co-ordination?

A. Oh, we have had many talks, very many, and we have worked out some co-ordination projects with individual truckers.

Q. Have you discussed the possibility of abandoning unprofitable branch lines and letting the independent truck operators handle the freight?

A. Well, when it comes to that, the railway is not a

free agent in the abandonment of a railway.

Q. I realize that; you have got to get permission.

A. We have, however, observed the results upon the territory of the abandonment of branch lines and allowing the community to depend purely on truck services, and it is a startling thing. I had an opportunity of observing a very careful study of that sort of thing in the Western United States, where a railway line of considerable length through an agricultural country was abandoned by reason of fierce truck competition that had destroyed all the high-value traffic and left the railway only handling lumber and coal and grain and, generally speaking, the heavy commodities moving long distances. A project study was made of that area to see what the result was when the railway service was withdrawn. The net result was -- it is a bit of an education -- in the first place the value of property, of the farm property in that area, went down about 30 per cent, if I recall the figure, and the over-all cost of transportation of everything that the community used went up a very substantial amount -- I have forgotten the exact figures. But, you see, immediately the community was thrown directly on the highway, and these heavy commodities had to be transported by truck, the basic high cost factor of the truck came to the front, and it was a beautiful illustration of exactly what I have been saying here. You see, these fellows living on the branch line, so long as they could ship their high-value commodities by truck, made an economy in their pocket, and the trucker made money and the railway lost money. Then when the railway decided it was all through with losing money and got permission to abandon the line, then the whole burden of transportation was thrown on the truck, and, being thrown on the truck, the truck, having to handle these heavy bulky commodities, just simply was forced to put in

rates in effect that were higher than they had been by rail, and that diminished the margin of profit of everybody in the territory, and that in turn reduced the value of their property. This study is a matter of record.

THE CHAIRMAN: Q. What was the final result?

A. Well, the final result is that all the people in the community just had to put up with a lower standard of living, that is all.

COMMISSIONER ANGUS: Q. Has this study been published?

A. I ran across it, oh, I think now about -- it was prior to World War II, and I think it was published, as I recall it; but I was interested enough in it at the time to go into it to make certain that it had really been a project study, and it was.

MR HUME: Q. Where was it, again?

A. It was out in one of the mid-western states, and it is a beautiful illustration of this thing that I have been talking about. On a small scale it illustrates exactly the nature of the problem.

Q. Now, as I understand you, you make the proposal that the Prince Edward Island---

THE CHAIRMAN: We will take a few minutes now.

(Recess)

(Page 20212 follows)

---After recess.

MR. HUME: Q. Mr. Fairweather, just before the recess I was asking you what efforts had been made to sit down around the table and see if you could work out your problems, since you have been studying this problem over the last twenty years, and you explained to me you had had some discussions with truckers about co-ordinated service. Can you elaborate and tell us to what extent that has --

A. These discussions have taken place at various times over the years. We are always ready to meet and talk these things over. I cannot go any further than that.

Q. I understand that the Canadian National Railways have recently made a proposal to the province of Prince Edward Island to substitute buses and trucks for rail service, and I wondered whether you had had any discussions with the independent truck operators there about the handling of freight or whether you are going to put on your own trucks?

A. In Prince Edward Island our intention was to put on our own trucks.

Q. Did you --

A. Incidentally, there is no regulation in Prince Edward Island. Any man can get a licence.

Q. There are independent truck operators on the Island, so far as you know?

A. Oh, yes, surely.

Q. Did you consider co-ordinating with them to save you purchasing your own equipment?

A. As I say, in Prince Edward Island we are figuring on acquiring our own trucks.

MR. O'DONNELL: You are referring to the discussions which the Canadian National has had with the government authorities of Prince Edward Island?

MR. HUME: Yes, it appeared in the transcript yesterday. Mr. Fairweather made some reference to these discussions.

Q. Would you say these efforts at co-ordination between the railway and the trucking industry have been material over the years or just token?

A. I don't know what you mean by "token", I am sure. We have had discussions. Usually when we analyzed the trucker's proposal we found he was on the make to the disadvantage of the railway.

Q. As you explained very carefully yesterday, you have a certain basic problem in this competitive factor, and you suggested yesterday that further co-ordination or co-operation might effect savings to the railroad and better service. You did not expand it and I was interested to know what you had in your mind.

A. I think it is obvious there are places where the use of the highway will mean that the railway can make economies and the community will get better service. That is the case in Prince Edward Island, and we have approached the problem to see whether we can get such a service installed. We have many places in Canada where we supplement rail service with highway service.

Q. Am I correct in understanding that your reference yesterday at page 20122 of the transcript was not to co-ordination with existing independent truck and bus operators but to co-ordination between the railway and railway-owned highway transport?'

A. Not necessarily; we have arrangements with independent operators.

Q. As I understand it, you have arrangements with independent bus operators for passenger service; is that correct?

A. And freight. We are willing to examine any proposal and if it meets sound tests of economics and prudent management - well certainly we have not got any preconceived idea of just what is going to be.

Q. As the senior service, so to speak, you want the truckers to come to you with proposals. May I ask this. You have a problem. Have you taken the initiative in any of these things?

A. Yes, I would say all of the proposals that we have put in that were found to be sound were initiated by us, or at least the majority of them. There may be one or two that came the other way, but by far the great majority came from the railway.

Q. Are you satisfied that the railway you represent is really doing its utmost to try to solve the problem by co-ordinate action between these two different means of transportation?

A. Co-ordinate action certainly would not solve the basic problem that I have laid out, but the subordinate problem of fitting the two services together where there is a real chance for economy and improved service is something that is receiving constant attention, yes. Incidentally, I have a responsibility in that.

Q. Have you ever published joint rates between the railway and an independent truck operator, that you know of?

A. Well now, you are really outside my territory now on the rate structure.

Q. All right, there is one last question, one last point which I should like to get at. You told us

yesterday and again to-day that you do not believe that restrictive legislation or restrictive control is the answer. May I ask you what about certain proposals that have been made before this Royal Commission to put federal regulation on interprovincial and international traffic?

A. Well, I have stated in my opinion that is a national problem, and to the extent that public convenience and necessity enters into it I certainly think it should be controlled from the national standpoint. That is the whole tenor of the Railway Association brief.

Q. If I may interrupt you there, I understand that your evidence yesterday which we have been discussing this morning somewhat gets away from that. You said you did not believe that restrictive legislation or restrictive control was the answer to the problem. May I ask you again whether or not you think restrictive legislation or restrictive control by the federal government will be any more the answer?

MR. O'DONNELL: On interprovincial traffic.

MR. HUME: Only interprovincial.

THE WITNESS: Again we seem to be at cross purposes as to the definition of "control". I have made my position as plain as I possibly can, and I have nothing to add to it except to say this, that one of the tools in my judgment which will have to be expanded and made more flexible to meet this problem is the agreed charge. I think that is one form of approach to this problem that holds some degree of promise.

Q. To get back to the question again, take the emphasis off the word "control" and put it on the word "restrictive" --

THE CHAIRMAN: I did not hear you.

MR. HUME: Q. To get back to my question again, take the emphasis off the word "control" and put it on the word "restrictive". My question was do you think federal restrictive legislation on international or interprovincial traffic is any more the answer than you have indicated previously?

A. I have gone over that time and time again and made my position plain. I have nothing to add to what I have said. It is clear on the record, as clear as I can make it.

Q. Will you bear with me when I explain to you that it is not yet clear to me. I think my question can be answered by yes or no. I will ask it again if you are not clear about it. My question is do you think that restrictive federal regulation on international and interprovincial truck traffic is any more the answer to your problem than you have already indicated?

A. I can only say my position is as clear on the record as I can make it.

THE CHAIRMAN: Q. Do you say yes or no?

A. I do not think I can answer yes or no to the question.

MR. HUME: That answer is probably self-explanatory. Thank you, Mr. Fairweather.

COMMISSIONER INNIS: Q. You have said a good deal about the developmental lines and the role that the railways have filled in opening up new territory. Are there many places where branch lines could now be built profitably?

A. Are there new places where branch lines could be built profitably?

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Q. Are there many?

A. Well now, profitable to the railway?

Q. I do not know what you have in mind. You have suggested throughout your argument that you have a great interest --

A. Yes.

Q. In developing new territory. You have indicated there are very few places where it seems profitable to build branch lines. I am wondering what you have in mind.

A. Well, there are not very many places where a branch line holds very attractive possibilities to the railway, at least for many years of development, but if you lift your sights to encompass the whole economy of the country that changes it entirely, and there are in my opinion many opportunities in Canada, or will be, for such development lines. We have several under study at the present time.

Q. You are making such a point of the disadvantages the railways were operating under following competition from trucks in opening up development territory?

A. That is right.

Q. I wondered whether you simply had in mind a sort of vague generalization about the future of the country or whether you had in mind specific developments?

A. I had in mind specific instances. We have before us at the present time several proposals for development lines, and if we were sure of receiving our proportion of the secondary wealth distribution created by that development, under a rate structure such as had existed prior to highway competition, it would make the problem of extending the branch lines much easier. That

is the point I wish to make.

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CROSS-EXAMINATION BY MR. MacPHERSON:

Q. Mr. Fairweather, in volume 65 of the evidence at page 13646 during the cross-examination of Mr. Walker by Mr. Covert a question was asked and an answer given, and I want to read the question as put to Mr. Walker and Mr. Walker's answer and to ask you whether or not you agree with it. This was the question:

"Q. Now, I just wanted to ask you one question on this point. I think an article was read to you this morning by Mr. Campbell suggesting that the railways may be pricing themselves out of business in the United States. My understanding is that your view is that that is not the situation in Canada, that the railways have nowhere near reached, I think was the phrase you used --

A. That is my view, yes.

Q. --- a rate level which would price the railways out of business?

A. Quite so."

Do you agree with that statement of opinion by Mr. Walker?

A. No, honestly I do not.

Q. Well, will you tell the Commission why you do not agree with it, Mr. Fairweather?

A. Well, I think that the tenor of my evidence explains my doubts and my disagreement. I think when the rate adjustments presently in effect and in prospect before the Board of Transport Commissioners, supposing they were granted in full, are applied, and having regard to this canker of highway transportation which I say is growing bigger, I have a real fear that the productive economy of our country will be disturbed and that marginal

producers will no longer be in a position to see enough profit in their operations to produce, and that could easily start a snowballing effect. I am a development officer, and as I have said, I firmly believe that our high standard of living is keyed into the incentive that is present in the producers of our basic commodities. Those basic commodities historically have always enjoyed low rates, and the prospect of increasing the rates beyond the levels that are now in contemplation is something that, as a development man, I look on with a certain degree of reservation. It is made clear in Mr. Gordon's brief that there is a 'fear' expressed there looking to the future that the railway might price itself out of its market.

MR. MacPHERSON: Thank you very much.

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CROSS-EXAMINATION BY MR. FRAWLEY:

Q. Mr. Fairweather, I only want to ask you about one matter. I do not suppose you have had an opportunity of reading the proceedings of Monday last before the Board of Transport Commissioners?

A. No, sir, I have not.

Q. In the so-called mistake application?

A. No, sir.

Q. During the course of Mr. Evans' argument in reply he touched on the question of the increases that had been made in competitive rates. I think I am putting it to you fairly when I say there was a suggestion from provincial counsel that further revenues might be obtained from competitive rates, and that probably the deficiency might be altered to some extent after further revenues had been taken from competitive rates. In his argument

in reply Mr. Evans was dealing with that suggestion. At page 6182 he said:

"Now, I say really what we have given by putting in that additional one per cent" --

I am sorry, Mr. Fairweather, that I have not the exhibit which would show clearly the one per cent Mr. Evans was talking about.

" -- is a gift to our friends" --
Provincial counsel.

" -- because we have not put it into effect.

There is doubt as to whether we will but it does decrease the deficiency to give credit for that increase which we have not got."

Then at the bottom of page 6182 he said:

"If you are going to increase these competitive rates up to the ceiling that they talk about, you quite obviously would not be meeting the competition and you would lose revenue -- not gain it.

Commissioner MacPherson: That is my point. Then, to obtain revenue you have to go to somebody else?

Mr. Evans; Exactly.

Mr. Frawley: You know where that is.

Mr. Evans: That is, as I say, to give our friends the benefit of an increase that we have not put into effect and probably won't put into effect as we did in putting that one per cent extra in there which is a gift to them."

(Page 20223 follows)

Now, Mr. Fairweather, I take it from that, without being unfair to Mr. Evans or what he was saying, that Mr. Evans was expressing the very real concern about the ability to further increase the competitive rates; would you agree with him in general about that concern?

A. Well, by definition, of course, a competitive rate represents a rate which the skilled ratemakers of the Traffic Department believe will move the traffic in question. These men are skilled in their job, and I am not a rate man, sir, but I think by definition a competitive rate must meet that test.

Q. That may be a little different aspect from the one which I am considering. You know that the history of the increase since the 8th of April, 1948, has been that the normal rates, the general rate level, has gone up 21 per cent and then 16 per cent, with a pending application for a further something like 4 per cent?

A. Yes.

Q. You know that at the same time competitive rates went up the 21 per cent which the general level took, then it was put up 15 per cent, speaking broadly now and generally, in September 1948, and that there has been no increase, generally speaking, since that time?

A. Generally I know that, yes.

Q. I say generally speaking, because there have been some adjustments and some cancellations, but generally speaking that has been the history of the increase of competitive rates. Now, all I want to know from you, Mr. Fairweather, is as to whether or not you think that the railways are gradually reaching a point where they are going to find it more difficult to increase the general level of competitive rates, if I might use that expression?

A. Well, really, as I say, I am not a traffic man, but

I do think this, that it is a very delicate thing when you start raising competitive rates to determine the point at which you lose the traffic. That is really all I could say.

Q. As you say, by definition, you certainly have not got the freedom in increasing your competitive rates that you have in increasing your non-competitive rates?

A. Yes.

Q. That is true. Now, at the moment there is pending before -- I suppose at the moment it is pending before the Minister of Labour -- an application for a wage increase which we are told might run to \$90 million, covering both railways. Now, if that should be translated into an increase in freight rates authorized by the Board sufficient to make up that demand in full, where do you think that freight rate increase is going to go, Mr. Fairweather?

A. Well, I suppose it can go where it can be collected.

Q. Yes, where it can be collected?

A. Yes.

Q. Do you think there is very much doubt about it that it is going to go on the non-competitive traffic in this country?

A. Well, I would imagine the greater proportion of it would likely go on to the non-competitive traffic.

Q. I should not be quoting Mr. Evans like that, but if that general concern is right, that the railways have perhaps just about reached the limit of the power to increase competitive rates -- as Mr. Evans says, they did not increase them all 16 per cent, when they increased the non-competitive rates by 16 per cent---

MR EVANS: Mr. Frawley, I do not mind you quoting, but I do not think you should start to put words in my mouth. I never expressed any concern, Mr. Frawley; I never spoke generally about the difficulty of increasing competitive

rates in the future. All I said was that with regard to that the 1 per cent had not been into effect.

MR FRAWLEY: That is right.

MR EVANS: I also said---

THE CHAIRMAN: I beg your pardon?

MR EVANS: The 1 per cent we were talking about had not been put into effect. What I also said was that the traffic officers were looking at all these competitive rates and were making changes in them, but that that 1 per cent had not been put into effect.

MR FRAWLEY: So that the Commission will understand quite clearly what this 1 per cent is---

THE CHAIRMAN: Instead of increasing the competitive rates by 16 per cent, you increased them by 15 per cent.

MR FRAWLEY: That is right. Now, let us take whatever we can out of the fact that the railways did not increase the competitive rates even by that 1 per cent when they increased the non-competitive rates 16 per cent. Now, just whatever reason there might be for that, perhaps it speaks for itself.

THE CHAIRMAN: Mr. Frawley, you are saying---

MR O'DONNELL: As I understand it, Mr. Frawley, Mr. Fairweather does not know anything about the details of the way that worked out.

THE CHAIRMAN: They did not increase the competitive rates even by that 1 per cent.

MR FRAWLEY: Even by a full 16 per cent.

THE CHAIRMAN: They did increase them 15 per cent.

MR FRAWLEY: That is right.

MR O'DONNELL: I may be wrong, my lord, but my understanding is, not only were they increased 21 per cent, and 15 per cent, but in many cases they were increased

100 per cent or more, in many cases cancelled, with the same effect as giving a very much greater increase. I think we have had that four or five times.

MR FRAWLEY: Four or five times? Fifteen times, I would think.

MR O'DONNELL: Well, let us be clear about it.

MR FRAWLEY: Q. At the moment at least, Mr.

Fairweather, the competitive rates have not increased the 16 per cent which the non-competitive rates were authorized to be increased; now, that is a fact, isn't it?

A. Well, I can only speak to that very generally, because rates do not come under my jurisdiction.

Q. Now, you were frank enough a moment ago to say that it would seem to you that if the freight rate structure had to carry this \$90 million which is now represented at the moment only in a wage bill, it might be represented by a freight rate bill sometime later, that the burden of that would have to fall on the non-competitive traffic, speaking broadly?

MR O'DONNELL: Do you want him to change the answer?

THE WITNESS: Well, my answer speaks for itself, but I might explain that in thinking it over, before I answered the question I reached the conclusion that the non-competitive traffic is greater in total volume than the competitive traffic.

Q. Now, Mr. Fairweather, knowing that the competitive traffic is by and large, the large bulk of it, in Ontario and Quebec, do you think that it is a good thing for this country to keep putting these increases on the non-competitive areas?

A. Well, speaking as a railroad man, I can only say this: The best thing I can think of for Canada is that we

have railways that are capable of performing efficient service, and we have to get revenues to do it.

Q. That is right.

THE CHAIRMAN: Mr. Frawley, may I ask you, what is your suggestion? Perhaps you intend to tell us later on. Are you suggesting -- you may as well tell me now -- that this attempt to meet competition should be abandoned?

MR FRAWLEY: No, my lord; but it does seem to me that this is an opportunity to focus in a very bright light this very serious situation, where the outlying parts of Canada are being gradually and gradually asked to bear the whole burden of the freight rate increases which these railways seem to need and which they seem to get.

THE CHAIRMAN: Do you intend to suggest to us later on just how that ought to be done?

MR FRAWLEY: Mr. Fairweather, who has been studying the matter for a long time, sir, has no solution. I am wondering---

THE CHAIRMAN: I am not asking you to, but perhaps you will have something to suggest.

MR FRAWLEY: Oh, we intend to discuss it in our general summing up, sir.

THE CHAIRMAN: All right.

MR BRAZIER: Just a few questions, Mr. Chairman.

CROSS-EXAMINED BY MR BRAZIER:

Q. Mr. Fairweather, Mr. Hume asked you a question or two regarding passenger traffic, and I think that you expressed the opinion that you were probably not any more than getting back your out-of-pocket expenses in operating your passenger traffic at the present time; is that a correct statement of your opinion?

A. Yes. One must, of course, understand that the

railway passenger service, as I said, is not something with regard to which the railway is a free agent. We have to run these services for public convenience and necessity. Now, if you take the whole bag of tricks, I think that the railway is lucky indeed if it gets back a new dollar for an old, but if you assume that it is part and parcel of the set-up of a railway industry that there shall be a passenger service, and you look then only to the volume of passenger service against that background, it becomes a little difficult, and it is such that I might illustrate it this way: It may seem a little odd, but if you apply my previous test that I illustrated with regard to freight traffic, if a man comes along and buys a ticket say from here to Winnipeg, we are very happy about it, very happy indeed.

MR O'DONNELL: Provided he goes on your line.

THE WITNESS: He naturally would travel C.N.R. if he wanted good service, highest quality. But we are very happy about it, and we take a very substantial portion of that ticket sale and it is net revenue; but if you take your set-up expense into account also, well, the picture is not nearly so attractive.

MR BRAZIER: Q. It is not an impossible task, Mr. Fairweather, to segregate out your passenger out-of-pocket expenses from your freight, is it?

A. Well, it all depends on how far you want to go. It is one of those costing problems; it can become very complex.

Q. Have you made any such studies at all?

A. Oh, yes.

Q. What has been the general tenor of the findings made by your studies?

A. Well, at the present time I would say that what you might call the out-of-pocket ratio on additional

passenger business in the Canadian National is somewhere in the neighbourhood of .75.

THE CHAIRMAN: Q. Of what?

A. .75. That is, if we get a dollar of additional passenger revenue, then applying my probability theory you would be reasonably sure of incurring expense of 75¢, so that you would have 25¢ available for general overhead. Individual cases would range all the way from a horrible loss in the event that you might have to put an additional car on the train to handle one passenger, and that would represent a loss, but on the other hand you might have almost 100 per cent profit when a man simply comes down and buys a ticket and hops on your train and gets off at a station where you have not added any service. But, taking the law of probabilities as applying to it, and for reasonable variations in traffic, we think that about 75¢ of expense accompanies one dollar of passenger revenue.

MR BRAZIER: Q. You are speaking there of the system as a whole?

A. Yes.

Q. Now, there is no doubt about it, Mr. Fairweather, you would have many passenger services in Canada aside from just the one passenger being added on one car, where there would be a substantial loss?

A. Oh, yes.

Q. Over and above your out-of-pocket expense?

A. But not on this out-of-pocket basis.

Q. You have no services on which---

A. I do not think there would be any that would meet that condition. You see, these public convenience and necessity services, consisting of services on branch lines, there is always there a capacity to handle much more traffic than offered, and therefore revenue picked up on services

like that is almost pure contribution to net. Where you get the expense factor involved is where you have to run additional car miles and additional train miles, and you find that situation in the inter-city traffic, where the set-up expense is relatively moderate in relation to the volume of traffic. If the volume of traffic increases you have to add first car miles and then after a bit you have to add train miles.

COMMISSIONER ANGUS: Q. If you apply your test to compensatory rates, and said, how much should we save if we did not have to handle that traffic at all, how would it work out?

A. The whole of the passenger traffic business?

Q. Yes.

Q. Taking the whole of the passenger traffic business, I think the Canadian National would probably -- it is a highly theoretical situation, but I think the Canadian National would probably find that it would have effected a greater reduction in expense than the reduction in revenue.

THE CHAIRMAN: Then the reduction in revenue?

(Page 20232 follows)

A. Suppose it was theoretically possible for the Canadian National Railways to pull out of the passenger business entirely, and to do it under such conditions that it did not thereby affect its freight traffic. Under those conditions, and they are highly theoretical, then I say the Canadian National Railways would save more money than the revenue they would lose.

COMMISSIONER ANGUS: Q. And on a branch line if it were a question of abandoning passenger service on that line I suppose there would be very big savings?

A. Almost invariably on this branch line service the revenues are only a fraction of the cost. That is why I refer to them as public convenience and necessity cases.

MR. BRAZIER: Q. You are aware, Mr. Fairweather, I presume that the Canadian National Railways charges a higher passenger fare in British Columbia than it does in the rest of Canada?

A. I really was not aware of that, no.

Q. If I state that to you as a fact, do you know any reason why that would be justified from the railway's point of view?

A. I can think of many reasons.

Q. I mean in comparison with other parts of Canada?

A. I would say if we can collect the revenue we would be very foolish not to.

THE CHAIRMAN: Would you repeat your question?

MR. BRAZIER: . I said that in British Columbia they charge a higher passenger fare than in the rest of Canada and I asked him if there was any reason to justify that from the railway's point of view?

THE CHAIRMAN: From point to point within

British Columbia?

MR. BRAZIER: That is right.

THE WITNESS: You could hardly expect me to answer that in the negative.

THE CHAIRMAN: The question is why do you do it.

THE WITNESS: Yes, but I said I did not even have knowledge that the rate was higher. Then he asked me to assume that it was higher, and could I justify it, and I would hardly answer in the negative.

MR. BRAZIER: Q. Your position is if you can get the extra revenue you may as well take it?

A. No, I did not say that. I don't know the circumstances, and I would be foolish to speculate on it.

Q. Do you think there is any greater loss incurred on passenger traffic in British Columbia than in other parts of Canada such as Newfoundland, for instance?

A. I have simply stated that I do not know the circumstances.

THE CHAIRMAN: It may be that it will be worth while to know this. Mr. O'Donnell can give us some explanation of it either now or later.

MR. O'DONNELL: I would be glad to look into it.

THE CHAIRMAN: Mr. Fairweather cannot do it.

MR. O'DONNELL: We will either get it through Mr. Fairweather or the department.

THE CHAIRMAN: I think Mr. Brazier is entitled to have that information. Mr. Brazier, did you say that condition exists on both lines of railway?

MR. BRAZIER: It exists on both lines of railway.

Q. You were aware of the existence of the mountain differential on freight rates, Mr. Fairweather?

A. Yes.

Q. Did you, from the point of view of the Canadian

455

National, think that you were justified in charging that higher rate?

A. Are you asking what the Canadian National policy was?

Q. No, give me your own opinion.

A. My opinion?

Q. Yes.

A. Well, the matter has been decided.

MR. O'DONNELL: It is a matter of judgment.

MR. BRAZIER: I think I am still entitled to ask this.

Q. Did you think it was justified prior to its being taken off by the Board?

MR. O'DONNELL: The point is, my lord, that my friend was successful. He got a judgment. We opposed it and argued against it. He has copies of all those arguments, I am sure.

THE CHAIRMAN: He must have convinced the Board that the time had come.

MR. O'DONNELL: Unless he would like to have it said that the Board was wrong.

MR. BRAZIER: I was going to tie it into the passenger fares.

Q. Have you ever made any studies to determine what percentage of the total expenses of the Canadian National Railways are fixed expenses regardless of traffic?

A. Oh, I have made many studies of the expenses of the Canadian National.

Q. When was the most recent one?

A. Oh, I am making them all the time.

Q. Did you make one for 1949?

A. As I say, we are making them currently. There is a branch of my --

Q. Taking a year period, have you ever made one for a year period?

A. Oh, yes. I don't know whether we made one for 1949. It is a current practice; it is a part of our budgeting procedure.

Q. What is the general result of your study, what percentage?

A. It all depends upon the density of traffic that the railway has.

Q. I am talking about the system as a whole.

A. I know; I am speaking of the system also. I said previously here that the operating ratio of the Canadian railways can be expressed by the formula that R, the operating ratio, is equal to a constant, C, divided by the revenue per mile with the addition to that of a constant fraction of .54. Now, that means that at the traffic density within the field of Canadian experience at the present time that constant, C, is \$8.270 per mile.

Q. You are speaking now of the Canadian National?

A. I think that is reasonably applicable to all Canadian railways. It is certainly applicable to the Canadian National. You will see that as traffic density increases the percentage which that constant expense bears to the total of the railway expenses will vary.

Q. Will it decrease as the density increases?

A. As the density increases the per cent of the fixed expense will decrease and the per cent variable would increase. For 1948 we figure that 56 per cent of our expenses were fixed and 44 per cent were variable. That is on a system basis.

Q. That indicates to you, does it not, rather low traffic density?

A. Well, it is based on low traffic density, certainly, those percentages. The Canadian National, as I have said, is a low traffic density railway.

THE CHAIRMAN: We find we have to adjourn a few minutes earlier to-day.

---The Commission adjourned at 12.55 p.m , to meet again at 2.45 p.m.

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Ottawa, Ontario,
Thursday, April 20, 1950.

AFTERNOON SESSION

S. W. FAIRWEATHER, Recalled.

CROSS-EXAMINATION CONT'D BY MR BRAZIER:

Q. Mr. Fairweather, I want to turn to another matter just for a few moments. I believe it is your opinion that truck competition is likely to become more severe in the future than it even has been in the past; is that correct?

A. Yes, unless remedial measures are taken.

Q. If the situation continues to develop as it is at the present time you are likely to have to meet more truck competition in the future?

A. Yes.

Q. That is the situation as they have found it in the United States today?

A. Oh, yes.

Q. And it is a very serious matter there for the railways?

A. Very serious.

Q. Now, what type of traffic is it that you would expect to lose to the truck?

A. Well, the traffic we lose to the truck is the relatively high valued traffic.

Q. The traffic on which the freight rate is high in relation to the cost of the service?

A. Yes.

Q. If that continued to its ultimate end I presume you would have nothing but the low-grade traffic left?

A. That would be a logical conclusion.

Q. And if that situation came about, then aside from obtaining a subsidy or some relief of that nature you would

have to make the low-rated commodities bear the total cost of your operation; is that correct?

A. Yes, at some level of service.

Q. Now, from time to time we have heard it mentioned that if the rates on some of these low-rated commodities were raised you would be likely to lose the traffic. I just wanted to direct your attention to coal at the present time, which has been mentioned as one of the low-rated types of traffic being carried by the railway. Would it be your opinion that if the rate on coal was moderately increased without a relative increase in the rates on other traffic you would lose a great deal of your coal traffic?

A. Well, I hardly understand you. You mean would there be less coal produced?

Q. Yes; would there be less demand for transporting coal in Canada?

A. Because there would be less coal produced, because the railways I think handle practically all the coal; that is one of the commodities that is pretty well left to us.

Q. Would an actual increase in the freight rate in your opinion be likely to decrease the demand for coal in Canada?

A. It would be a factor.

Q. I am speaking now of a moderate increase, not any---

A. Well, I really would not---

THE CHAIRMAN: Let me understand you. Decrease the demand for coal, in favour of what other product?

MR BRAZIER: I was not trying to develop any relative position of any other types of fuel, but just as to whether or not coal in itself could stand a somewhat higher freight rate than it is paying at the present time.

THE WITNESS: Well, that is a debatable point. I

think that as you raise the freight rate you have some effect upon the marketability of the product, and I think it would apply to coal, but I would not be prepared to say how much.

Q. Now, there are one or two railways in the United States that handle almost exclusively coal; isn't that correct?

A. Yes.

Q. The Norfolk & Western?

A. Yes.

Q. Something over 90 per cent of its traffic is coal?

A. That is true.

THE CHAIRMAN: What railway is that?

MR BRAZIER: The Norfolk & Western Railway.

Q. And in that case it is reasonable to presume that the coal is bearing the total cost of operating the railway?

A. Yes.

Q. Not just its bare out-of-pocket expenses?

A. That is correct.

Q. And the Norfolk & Western is one of the more successful railways of the United States?

A. Yes.

Q. From an earning point of view?

A. Yes.

Q. Now, you have during your evidence, Mr. F irweather, stated, I think, on several occasions that the railways provide the cheapest form of transportation, but I believe this morning you rather qualified that by saying that there was a sphere in which the truck was the cheapest form of transportation; is that correct?

A. Yes, and I qualified it previously too. I said that the railway is by long odds the cheapest form of mass land transportation except within a zone, a short-haul zone, where

where the truck would take over, and except also for the movement of large quantities of liquid in pipeline.

Q. That would be particularly true, I presume of the economy of truck transportation, particularly true in or near large metropolitan areas; is that correct?

A. Which? The zone in which the truck ~~axis~~ is more efficient? ?

Q. Yes.

A. Yes.

Q. Where you have actually a relatively expensive terminal operation?

A. Well, of course, the truck also gets into a terminal situation in these large centres, but there is a field of opportunity for the truck in radial service out of large centres, and I think they can do a more economical job than the railway up to a zone, up to a rather indefinitely defined distance.

Q. Now, would you say that generally speaking the railways have withdrawn from the field of transportation in which the truck is most economical?

A. I would say yes to that. I think that where the situation is that the truck is the more economical medium, the railway has largely withdrawn. Of course, there is always a rump of public convenience and necessity under which we have to publish rates and things like that, and there will be a certain amount of traffic coming to the railway, chiefly traffic which the truck does not see fit to take.

Q. I would like to direct your attention to the pick-up and delivery rates that you have, particularly in Eastern Canada. Do you think in that sphere probably the truck is the more economical means of handling that traffic?

A. It depends on the distance between termini. For

instance, on an l.c.l. movement between Winnipeg and Montreal I am perfectly certain that the railway is the more efficient medium. As the haul between the termini decreases there does come a point where the truck becomes the more efficient medium, and I would say that probably under present-day conditions that zone is somewhere in the neighbourhood of perhaps 100 miles or something like that.

Q. About 100 miles?

A. About 100 miles; maybe a little more today, a little less tomorrow.

Q. In these cost studies that you have made, Mr. Fairweather, do you make a segregation there of your line haul costs and the terminal costs, as the I.C.C. does?

A. Oh, certainly.

Q. And has it been your experience that your terminal costs in centres such as Montreal is continually mounting?

A. Well, all our costs are continually mounting.

Q. Might I put it this way, proportionately more than---

A. No, I would not say proportionately more.

Q. Now, we have heard during the hearing here a great deal about the value of service principle in fixing rates. I do not want to question you about particular rates or anything, because I understand that is not in your field. It is true, though, is it not, Mr. Fairweather, that value of service varies by commodities? That is a principle under which the standard classification is established?

A. Oh, yes.

Q. In this country does the value of service also vary by regions?

A. I hardly know what you mean by that. Would you elaborate your question perhaps a little?

Q. Well, if you have a higher rate in British Columbia than you have for the same commodity in Ontario, say, and not

taking into account truck competitive rates, but two commodities, one in British Columbia and one in Ontario, where the one in British Columbia is the higher, does that indicate a variation in the value of service by regions as well as by commodities?

MR O'DONNELL: Would you just mention a couple of---

MR BRAZIER: We mentioned fruit rates previously.

THE WITNESS: Well, I can only say that the freight rate structure is, as I conceive it, a compromise between a lot of things, and one of those is the principle of value of service and another one is the necessity of getting enough revenue to meet your expenses.

Q. I wondered if you would concede that the value of service varies not only with commodities but with the degree of monopoly, might I say, which you have in handling the traffic?

THE CHAIRMAN: Pardon me. Do you mean monopoly for this particular railway, or for the railways?

MR BRAZIER: Railways; I am speaking generally.

THE WITNESS: Well, if you have a free competitive economy the value of service immediately drops down to the cost of service, and it is obvious you cannot maintain the principle of a value of service above cost unless you have absence of a functional competition.

COMMISSIONER INNIS: Q. You were saying that the trucks were taking off types of commodities which were particularly affected by value of service?

A. Previously, sir, yes. You see, our rate structure was moulded in a period and more or less fixed in a period before this new medium of transportation came along; therefore there is now an artificial condition.

Q. Do you think that the position of British Columbia

is rather more warranted than it would have been? I am assuming that since the value of service principle has less significance therefore the cost of service probably has more significance.

A. I should imagine that would be a logical assumption.

MR BRAZIER: I think the question you have just put was the last question I had, sir. Thank you.

THE CHAIRMAN: Anybody else?

CROSS-EXAMINED BY MR EVANS:

Q. Mr. Fairweather, before I begin my cross-examination -- that is to say, the planned cross-examination -- I want to ask you one or two questions about the matter that Mr. MacPherson asked you about. I think Mr. MacPherson put to you a statement by Mr. Walker to the effect that the railways of Canada had not at the moment reached anywhere near a point of pricing themselves out of the market, and I think you gave as your view that you could not agree, and I think in answer to Mr. MacPherson's further question you also said that the reason for your view was the matter of motor competition.

(Page 20245 follows)

Now, may I suggest this to you, that when you speak of pricing oneself out of the market one has to bear in mind the extent to which inflation has proceeded in prices generally?

A. Oh yes.

Q. So that one could not, I suggest, generalize that railway rates had proceeded to the point where they had priced themselves out of the market, or that they were approaching that, unless one considered the matter of inflation in prices generally?

A. Oh yes, not only in Canada but in the markets and the alternate supplies in world markets with which Canadian products find themselves in competition. It all has to be looked at.

Q. When one comes down to the question of motor competition one would also have to bear in mind that the question as to whether in a given case one had reached the point of diminishing returns, because I imagine that is what you have in mind, one would have to know what the effect of inflation was on one's motor competitors?

A. Oh, decidedly.

Q. So that by and large would you agree with this, that the question as to whether one has priced oneself out of the market by increases in rates really depends on the extent to which the existing policies are producing a tendency to ^a greater amount of highway competition than we have had in the past?

A. No, I would not say that.

Q. Let me put it to you this way, that there has been in recent years perhaps a continuation of the tendency we found in the years immediately preceding the war, the recent war, a continuation of government policies in building roads and providing facilities which make possible increas-

es in motor competition?

A. Yes, I would agree with that.

Q. So that having got to the point with you that inflation does affect the motor competitor, I suggest to you the principal factor in this question of pricing oneself out of the market is the continuation of those policies which make possible an increasing amount of motor competition?

A. It is certainly a factor.

Q. I just wanted to get that cleared up with you because I was a little in doubt as to what you had in mind. Now then, if I may turn to a general approach to my cross-examination of you, I put to Mr. Cooper one or two general questions in opening my cross-examination, and if you will forgive me I should like to ask the same questions of you. I am reading from page 18917 of the transcript. I should like to ask you this question, and I am going to put it exactly in the same form as I put it to Mr. Cooper.

MR. O'DONNELL: What volume?

MR. EVANS: Volume 102.

Q. This was the question in part. There was a little introductory part but the question was this:

"--would you not agree that anything which weakens or affects the ability of the Canadian Pacific"--

Do you follow me there? It is just below the middle of the page.

"--would you not agree that anything which weakens or affects the ability of the Canadian Pacific to operate and maintain its railway properties and to serve Canada would, to use the words of Mr. Gordon, weaken the country generally?"

A. Yes, I would agree with that.

Q. Now then, the next question I asked Mr. Cooper was:

"Q. Now, as a further step, the position of the Canadian Pacific, or for that matter any privately-owned railway, would be weakened if it were compelled to provide a service at lower than a reasonable return on its investment, whatever that may be, whatever the Board may decide that may be?"

A. Well, I feel that the matter of rates being subject to the Board of Transport Commissioners, they having set a rate it is the fair and reasonable rate. That is the only answer I can give you.

Q. I wonder if that is perhaps an answer. You, I think, would agree that the Canadian Pacific must depend on its own resources, would you not?

A. Oh well, historically I don't know that that is strictly true, but I would say currently it may be true, yes.

Q. Have you any doubt that it is true, that they must depend upon their own resources for attracting capital and for money to carry on their service?

A. Well, I really don't know what might happen under hypothetical conditions. There have been cases where the Canadian Pacific has received capital other than through their own resources.

Q. You are thinking of subsidies?

A. I am thinking of subsidies and loans and one thing and another, yes.

Q. But unless we go into the matter of subsidies as a continuing feature of the railway situation in this country I think you must agree with me that the Canadian Pacific must depend on its own resources?

A. So far as its railway operations are concerned under

rates approved by the Board of Transport Commissioners in the light of all the circumstances.

Q. But are you not prepared to agree those rates have to be fixed with regard to the need of the Canadian Pacific to earn sufficient money to pay its way?

A. I believe that has been the uniform policy.

Q. Do you have any doubt in your mind as to that being the proper policy to pursue?

A. No, I haven't the slightest doubt in my mind as to the policy but what I am being careful to avoid is that I am not going to say that a rate fixed by the Board of Transport Commissioners as being fair and reasonable is not so.

Q. I am not asking you to.

A. That was really the only reason why I qualified my answer.

Q. Because Mr. Cooper after some further interchange said on the following page when I pressed him on the matter and spoke of a fair return on its investment:

"I see. Well, I would agree with that, because I know that is the policy generally followed in the United States, and it seems to me to be logical, and I would be inclined to agree with your statement."

Have you any doubt in your own mind?

A. Well, I certainly have no doubts of the fairness of the Board of Transport Commissioners, no, not the slightest.

Q. Would you express an opinion as to whether, in your view, it would be desirable to maintain the Canadian Pacific as a healthy and sound private enterprise competing with the Canadian National?

A. Oh, decidedly; I have very strong views on

that. I believe the two railways competing in healthy fashion in this country furnish this country with the cheapest form of railway transportation that can be found anywhere in the world, and I think each company reacts on the other advantageously to that end.

Q. I think you and I are in agreement on that as we have often been in the past on a number of things. Would you say that is the official position of the Canadian National?

A. I would certainly say so, yes.

Q. Can you say whether it is or not?

A. Well, I think it is the declared policy of the Canadian National.

Q. Now then, I think you will agree with me this far, that leaving aside for the moment the question of subsidy if the Canadian Pacific does not earn a reasonable return, whatever that may be, on its investment in railway operations its position would be greatly weakened?

A. Well, I think that would depend a good deal on the circumstances. I do not see these things as having a precise definition. Again I can only go back to the general belief that on the average it has been found possible to provide conditions under which the Canadian Pacific Railway has operated and shown reasonable profits and reasonable stability, and that such would likely continue.

THE CHAIRMAN: Pardon me, so that we will understand it, what is your definition of the word "reasonable"? Is it what the Board thinks is reasonable or what the investing public think?

MR. EVANS: I would not want to suggest what the Board might arbitrarily think was reasonable, but what the

board might find having regard to the need for earning a return on investment and the need for attracting capital. I think the Board would have to make a judicial finding based on the evidence before it as to the need for keeping the Canadian Pacific solvent, and that would depend on evidence as to the marketability of securities, its ability to obtain capital, and what was needed to service capital.

THE CHAIRMAN: Is your basic position today not this, that your present return is not a reasonable one?

MR. EVANS: Oh yes.

Q. You seemed to have just a little qualification in your mind, Mr. Fairweather, and I want to clear it up. Doesn't it follow that if Canadian Pacific as a private enterprise is to carry on as such, and leaving aside matters of subsidy, it must have out of its earnings sufficient to enable it to carry on and to attract capital and to pay its operating expenses?

A. All of these things are matters to be determined by the Board of Transport Commissioners.

Q. Well, I thought perhaps we must first establish the principle. What the determination of the Board may be on the particular facts is one thing, but do you not agree, as a Canadian National officer, that that is essential to keep the Canadian Pacific in operation?

A. I have already expressed my views as to what I consider to be desirable.

Q. Perhaps I have misunderstood you. Do you or do you not believe that the Canadian Pacific in order to remain a private enterprise, which you say is desirable, must have rates which return to it sufficient to enable it to service its capital and to attract new capital to the enterprise?

A. Yes, and my answer is that is a matter which from

time to time is before the Board of Transport Commissioners for determination, and reviewing the history of it I have never seen any evidence in the past that over a period of time it has ever failed, and I say again that I would think that the same conditions would rule in the future, but I cannot be a prophet on the thing.

Q. I am not asking you to be a prophet, and I am not asking you to determine what the Board might find, but as a matter of principle is it not your view, and the official view of the Canadian National, that it must be true that in order to keep the Canadian Pacific as a private enterprise in competition with the Canadian National, which you say is desirable, it must have rates fixed at a level which give efficient operation, and will keep it in a position to pay its way, and to service its capital and to attract new capital?

A. Well, I really cannot go any further than I have. These things are matters to be determined by the Board, and so far as principles are concerned the principle is admitted that the Canadian Pacific Railway, I take it, is to be continued as a healthy and efficient enterprise, and everything necessary to achieve that end will be given attention by competent bodies. I express confidence that will be done but I am not in a position to say precisely what formula would be used to achieve it.

Q. I am not asking you to say that. You say it is desirable that that be done, but I think you must agree also whatever is necessary to do it should be done? Would you go that far?

Q. I believe sincerely that the preservation of the Canadian Pacific Railway is a desirable part of the transportation situation in Canada.

Q. Are you not prepared to say that the Board should do whatever is needed to be done for that end?

A. I have said that by one means or another I have confidence that such would result, but I am not prepared to say what the precise machinery would be.

Q. I am not asking you that. You say you have confidence that will be the result, but I suppose you must have confidence that would be a desirable result?

A. Yes, I said it would be a desirable result.

Q. I am sorry if I have been obstruse. I thought that was perhaps what I ought to get. Now then, I suppose you would also agree that as regards the Canadian Pacific as a private enterprise it has a problem of fixed charges in itself, that is to say, it must never let its fixed charges get beyond manageable limits having regard to its earningpower?

A. That would be prudent management, yes.

Q. So it follows, I think you will agree, that one of the essentials in keeping the Canadian Pacific afloat financially is that it must have a substantial proportion of its capital supplied by the issue of equity securities?

A. Equity capital, whether it be securities or in other forms.

Q. perhaps you and I had better get to a common denominator on what securities mean. I am thinking of equity shares or equity capital, as you call it, in the form of shares of some kind.

A. Or it might be retained earnings.

Q. Oh quite, through either surplus earnings or through through issue of equity capital in the form of shares?

A. Or other forms of capital.

Q. Well now --

A. You see --

Q. What other forms of capital have you in mind?

A. I should think if you examine the history of the Canadian Pacific you would find other forms of equity capital than you have enumerated, and I am not going to deny the possibility of the same occurring in the future.

Q. I do not want to split hairs with you.

A. I know that.

Q. I just want to get from you the idea that you follow me in this process of reasoning, that so far as a private company is concerned it has not only a problem of fixed charges but it has a problem of keeping a proper relationship between its equity capital and its fixed charge capital or its debt capital?

A. It has certainly a problem in seeing that its interest bearing capital does not get too heavy.

Q. Yes.

A. I would agree with that.

Q. As a part of that problem and in order that its interest bearing capital should not get too high in relation to its total capital it has to be able to issue its equity capital to the public in terms which provide a reasonable expectation of profit to the holder of the security representing the equity capital?

A. That would be one solution.

Q. Well, is there another?

A. Well, I have already mentioned the possibility of retained or surplus earnings.

(Page 20255 follows)

Q. Oh, quite; but if there are retained or surplus earnings, that would be after dividends are paid to the equity capital holders, wouldn't it?

A. Well, there might be surplus earnings and no dividends; that has happened with many enterprises. In fact, I own some stock in a company in which that is just what is happening.

Q. May I suggest to you that that has been the condition of the Canadian Pacific as regards railway earnings for many years?

A. Yes.

THE CHAIRMAN: That has been what?

MR EVANS: The position of the Canadian Pacific as regards railway earnings for many years.

Q. But what I am saying to you, Mr. Fairweather, is this, that surplus earnings very rarely provide all the capital that is needed in a company?

A. Well, I do not know that under modern conditions I could altogether agree with you. I have been most struck by the fact that there has been very little equity financing done by industry in the last couple of decades.

Q. I wonder if that was really the question, Mr. Fairweather?

A. Well, I thought it was.

Q. I suggest to you that it is very rarely the case that all of the capital required can be provided from surplus earnings today?

A. And I thought I answered it.

Q. Well, if you did I missed it.

A. Well, would you read my answer, please?

THE REPORTER: "Well, I do not know that under modern conditions I could altogether agree with you. I have been most struck by the fact that there has

been very little equity financing done by industry in the last couple of decades."

MR EVANS: Q. Well, let us assume that that is treated as an answer to my question; I do not want to get at cross purposes with you. But would you say that the failure to finance through equity capital issues in recent years has been because they were able to get all the capital they needed through surplus earnings?

A. Well, I would say generally industry in this country has done a pretty fair job at expanding its capital in that manner.

Q. Then would you say that is true of the Canadian Pacific?

A. I think the Canadian Pacific has done a remarkable job in that manner.

Q. You think that they have a reasonable prospect under present conditions of financing their capital requirements through surplus earnings?

A. Well, I am not too familiar with all of the accounts of the Canadian Pacific Railway. I do not know how much they would have, really, and I could not answer your question for that reason.

Q. Then, if I may turn to another subject, do you think it desirable that the Canadian National should become a yardstick for rate-making purposes in Canada, either alone or in conjunction with the Canadian Pacific?

A. Well, it has been no part of the submission of the Canadian National that the Canadian National should be such a yardstick.

Q. I realize that, Mr. Fairweather, but I think the question was this: Do you think it is desirable?

A. Well, I think this, in all fairness, that to take the Canadian National in as a yardstick for rate-making in

this country, either by itself or in conjunction with the Canadian Pacific, would pose a very complex problem indeed. I have never bothered to give it too great consideration, because there are such profound differences between the two properties and their needs are therefore different. The capital readjustment that is asked for by the Canadian National was all viewed against a background of the type of rate control that has been the average experience in the past, modified by discernible trends.

Q. Now, I am not sure whether you have given me quite an answer to my question, but, all things being equal, do you think it is desirable that the Canadian National---

A. I do not think all things can be equal; that is my trouble. You could at any one point in time make an adjustment which would bring the requirements of the Canadian National and the Canadian Pacific into relative balance one with the other, but under another set of conditions that would not necessarily hold, and I, as I say, feel that there are these differences, and it would require a very great deal of study in my opinion before one could put the Canadian National into a position such as you have suggested. I do not say that it would be impossible, and I am not saying that it might not be desirable or undesirable; I simply say that it is a very complicated matter, and the Canadian National in making its submission did not give weight to any such thought. What the Canadian National was trying to do was to get out of the poorhouse, if you want to put it that way.

THE CHAIRMAN: Q. Trying to do what?

A. To get out of the poorhouse. We wanted to have a target that we could reasonably shoot at under conditions similar to those that we had experienced in the past, modified by discernible trends, and that was our limited

ambition and is our limited ambition.

MR EVANS: Q. May I say that I am quite sympathetic with the idea that you should be in the position you seek, as long as it does not do harm to me. I have a lot of sympathy for the position.

A. May I make it perfectly plain that there is not the slightest thought in this Canadian National submission of any damage to the Canadian Pacific Railway, and I will say further that the relief given to the extent that is recommended by the Canadian National management does not in my judgment offer a threat to the Canadian Pacific Railway.

Q. Well, I am going to have to explore that a little bit with you. If we could come back to this question of yardstick, I think the substance of your answer was this, that there were great difficulties in the way of making the Canadian National a yardstick in rate-making in this country, that however desirable that may be, there was quite a problem to be solved before that could be the case?

A. Yes, and that in making the adjustment or asking for the adjustment we have asked for there is no intention or thought or design or expectation that it would damage the Canadian Pacific Railway.

Q. Now may I put this question to you -- and I hope you do not think I am being unfair to you: Would you agree that until these difficulties are solved -- and when I say solved, I mean that they must be solved in a way that will protect the Canadian Pacific -- that the Canadian National would support a provision, in legislation if necessary, that until this difficulty is solved the Canadian Pacific must have sufficient earnings to maintain itself as a private enterprise?

A. I could not give an answer to that question.

Q. Well, but I am wondering whether you could not support the principle of it?

A. I could not give an answer to that question, possibly.

Q. And your difficulty in not being able to give an answer is what?

A. Well, I think it is self-evident.

Q. Would you explain to me, because I am just---

A. Well, consider in the first place my position in relation to the Canadian National, and then consider the position of the Canadian National in relation to its problems. Our problem is a simple one, and we have declared, and I am declaring again, that the solution that we suggest does not do the Canadian Pacific any damage. Now, that is the position of the management of the Canadian National Railways.

Q. Now, supposing it could be shown that there was a possibility of damage, would you support measures to prevent that damage happening?

A. Well, I would await the event. I am confident---

Q. In other words, you would wait till the horse was stolen before you would lock the door, would you?

A. I would await some tangible evidence rather than a purely hypothetical condition.

Q. Well, perhaps I can give you that evidence. Now, when the Canadian National does become a yardstick, if it ever does -- and I think we have from you that, assuming these problems can be solved---

THE CHAIRMAN: You have some what?

MR EVANS: Q. I think we have from you that, assuming these problems can be solved, it might be desirable that they should become a yardstick along with the Canadian Pacific; how would you expect the Board of Transport Commis-

sioners to establish the needs of the Canadian National with which to measure the level of rates?

MR O'DONNELL: My lord, I do not want to interfere or object, but I am just wondering under what provision in the reference that particular question would fall. There is no request that we be made the yardstick. We have not said anything in the submission about it, and what may happen in years from now, as Mr. Fairweather says, he assumes will be taken care of then, but for the time being, under the reference which this Commission has, I just wonder where my friend's question falls.

THE CHAIRMAN: Well, it may be one of the principles that we are asked to indicate, guiding the Board in what it does about fixing rates. What are you trying to do, Mr. Evans, may I ask you? Are you trying to build up a case to show that in no circumstances should the Canadian National Railways be used as the yardstick for the fixing of rates, either by itself or in conjunction with your railway?

MR EVANS: Yes.

THE CHAIRMAN: Well, that is all right, then.

MR O'DONNELL: Also asking Mr. Fairweather what his particular view is. I do not like to object, because---

THE CHAIRMAN: Pardon me?

MR O'DONNELL: I say I do not like to object. The question just before, asking Mr. Fairweather if he would support the proposal that was put, is just a little bit enthusiastic.

THE CHAIRMAN: I think Mr. Evans is entitled to tell us what his case is, and then to build it up. Now, whether Mr. Fairweather is the proper witness to address those questions to I really do not know yet; it depends on what the attitude of the railways is.

MR EVANS: May I just put this position to you, sir: We have been told that Mr. Cooper and Mr. Fairweather together would answer all questions on the submission of the Canadian National, including the submission of Mr. Gordon. Now, I think from the judgment of the Board in the September 1949 decision it was a part of the Board's view that the time might come when the Canadian National should become the yardstick for rate-making.

THE CHAIRMAN: Did you say a yardstick or the yardstick?

MR EVANS: A yardstick or the yardstick. I have forgotten the language that was used.

THE CHAIRMAN: I would like to have just what they did say there, if you have it.

MR EVANS: I will have it looked up. What I was going to say to you is this---

THE CHAIRMAN: You are not prepared to give me that now?

MR EVANS: I have not got the exact reference, but I will get it.

Now, there was a very considerable amount of discussion, and I am not for a moment suggesting that my friend was not perfectly justified in the position he took, but my friend Mr. O'Donnell was fighting very strenuously with the provinces, that his requirements, his needs, his accounts, had to be taken into account. Now, that is the first point.

The second point is this: I want to explore this with Mr. Fairweather to find out what happens if surplus earnings are made. Now, our fear is that surplus earnings, unless they are bound to be turned over to the equity security holder by way of return, will lead to pressure to produce a tendency to make the Canadian National the

yardstick. Now, the question I was asking Mr. Fairweather was, if that were the case what would he, as an officer of the Canadian National and speaking for it on matters of policy as well as giving his personal view, what would he advocate to the Board of Transport Commissioners as the measure of the needs of the Canadian National?

THE CHAIRMAN: When you say "he", do you mean the Canadian National Railway Company?

MR EVANS: Yes.

THE CHAIRMAN: Then is Mr. Fairweather's the best evidence we can get of what the attitude of your company would be in such a case, Mr. O'Donnell?

MR O'DONNELL: Mr. Fairweather is as fully qualified as anyone I know of, as far as that is concerned. All I was pointing out, though, my lord, was that there was no request that the Canadian National be made the yardstick, and neither Mr. Gordon nor Mr. Cooper nor Mr. Fairweather has said anything about it, so far as rates are concerned.

THE CHAIRMAN: Now, while that is quite so, you told us yourself here some time ago, you made that statement yourself too, that you were not asking to be made the yardstick.

MR O'DONNELL: That is right.

THE CHAIRMAN: But then others are concerned in this question of how the yardstick shall be adopted besides the two railways, you see.

MR O'DONNELL: That is true.

THE CHAIRMAN: Mr. O'Donnell, you understand that.

MR O'DONNELL: And, as I understand it, under the Board's---

THE CHAIRMAN: As Mr. Evans has said, pressure may be brought to bear sometime or other to have your company

made the yardstick.

MR O'DONNELL: Yes.

THE CHAIRMAN: Well, therefore I think it is proper to canvass now---

MR O'DONNELL: Under the Board's judgments in the past the Board has taken the position that rates just and reasonable must be just and reasonable to railways and to shippers, not just to one railroad but to all railroads, and we are quite satisfied to leave that within the jurisdiction of the Board of Transport Commissioners, and heretofore the Board of Transport Commissioners through the years has always seen to it that all the railroads got what they considered a fair deal, and for the last twenty-five years the Canadian Pacific's requirements have been taken as the yardstick, but tested against the requirements of the others as well.

THE CHAIRMAN: That is the very point.

MR O'DONNELL: We have not asked any change in that at all, my lord.

MR EVANS: I think my friend ought to go further. I think my friend ought to say this, that not only does he not ask for a change, but he would support legislation which would not change it, in the circumstances in which we now find ourselves in connection with this recapitalization proposal. If he would do that, I would pass to another subject, but you see---

THE CHAIRMAN: Yes, but, as I have been trying to point out, it is not a question that lies entirely between you two gentlemen or between your two railways; other people may be concerned.

MR O'DONNELL: That is right.

THE CHAIRMAN: With that very same question, as to what is to be the yardstick in fixing rates.



MR O'DONNELL: The question that provoked this discussion was---

THE CHAIRMAN: That being the case, I think Mr. Evans is quite entitled to ask Mr. Fairweather to give him his opinion.

MR O'DONNELL: Well, the question that provoked my remarks was as to whether or not Mr. Fairweather would support legislation. I did not think that that was quite---

THE CHAIRMAN: I do not think he asked Mr. Fairweather whether he would support legislation.

MR EVANS: I think I went that far.

MR O'DONNELL: Yes; that was what I was objecting to.

MR EVANS: Whether the Canadian National---

THE CHAIRMAN: Well, all right. If you wish to ask the Canadian National whether it will support legislation, now what would be the effect of the legislation you have in mind, so there may be no misunderstanding?

MR EVANS: I will be very glad, and I will ask the question of my friend Mr. O'Donnell if he prefers that I do not ask the witness -- ask the Canadian National officially whether they would be prepared to support legislation making the Canadian Pacific the yardstick until some solution was found by which it can be guaranteed that the Canadian Pacific while efficiently operated will have sufficient money to carry on as a private enterprise.

MR O'DONNELL: That is a question that I think is unfair. My friend has used the word "unfair" many, many times. That is one that is unfair. We have not asked that the requirements for determining rates or the yardstick which has heretofore been used should be changed. Now, to ask whether we would support legislation or not, furthermore, I think is a matter of irrelevance, inasmuch as your lordship

has just remarked that many, many other people have something to say about that thing; but putting that question to Mr. Fairweather I thought was going just a bit beyond what is properly justified in the circumstances.

THE CHAIRMAN: Now, Mr. Evans, we have heard from time to time as we have been proceeding about the question of amendments being drafted. It does seem to me that if you have any legislation in mind, it is very important.

MR EVANS: I have drafted and submitted to the Commission an amendment.

THE CHAIRMAN: You will submit?

MR EVANS: I have done.

THE CHAIRMAN: Oh, you have?

MR EVANS: Yes.

THE CHAIRMAN: I have not seen it yet.

(Page 20266 follows)

MR. EVANS: I would be very glad. Having regard to these developments --

THE CHAIRMAN: When did you submit the amendment?

MR. EVANS: On the date fixed by the Commission.

THE CHAIRMAN: Oh yes, on the 12th of April. None of us have happened to see it yet. May we see it now?

MR. EVANS: Yes. May I read it to you?

THE CHAIRMAN: Yes.

MR. EVANS: Before I do, you asked me first to give you the reference in the judgment of the Board in the September decision where the subject of the Canadian National becoming the yardstick was mentioned, and I would be glad to read this little passage to you. It is from page 11 of the printed pamphlet copy, and after referring to the fact that the Canadian Pacific had been the yardstick for all other railways in Canada it said this:

"It may very well be that the proper basis for establishing freight rates in this country should follow a revision of the capital structure of the Canadian National Railways and the appropriate statutory direction to this Board as to freight rates based on that valuation."

I would have thought that perhaps it was quite obvious that if that position has been taken by the Board -- and certainly it was not prompted by my friend, Mr. O'Donnell, it was as much prompted by his own thinking arising out of the anxiety of the Canadian National to be taken into account, and mind you I am not objecting to that but all I say is if it is in the Board's mind today, a recapitalization such as we have proposed here, it will be in the public mind tomorrow, and it is more importantly in the Board's mind today. If that comes about how are we going to give effect to this, how are we going to provide for a measure

of rates that will give the Canadian Pacific a chance to survive? I hope my friend did not misunderstand me.

MR. O'DONNELL: I did not misunderstand my friend at all, but I say this, with respect and deference to him, that Mr. Fairweather has already answered that question. Mr. Fairweather said before that could happen many things would have to be done, studies made and adjustments and other matters to put this railroad on a basis comparable with the other. That is the gist of the evidence as I understood it, but for my friend to go on and ask if this road would support legislation of a particular kind or another I think was going a little bit beyond where he should have gone.

THE CHAIRMAN: I didn't know a few moments ago what we know now. You have seen the proposed amendment, have you, Mr. O'Donnell?

MR. O'DONNELL: Yes, I saw it.

THE CHAIRMAN: I do not want to be premature with you. Have you made up your mind about it?

MR. O'DONNELL: We will have something to say about it, I assume, when it comes the right time, but I don't think this is quite the right time. To ask Mr. Fairweather to commit himself or his company to supporting legislation that my friend thinks desirable even before the matter has been debated or argued before the Commission is something else.

THE CHAIRMAN: You have this amendment before you, have you?

MR. EVANS: Yes, I would be glad to read it to you. It is by way of amendment to Section 325 of the Railway Act. The subsection reads this way:

"Rates shall not be deemed to be just and reason-

"able unless, taken as a whole, they are sufficient to provide a fair return upon the investment in the railway property of Canadian Pacific Railway Company and the Board may from time to time determine the investment in railway property upon which the return is to be calculated and the rate of such return."

I may say that the insertion of the words, "Canadian Pacific Railway Company" does not in terms exclude at some time taking into account the Canadian National, but it does make it necessary by statute that the Canadian Pacific should have a fair return.

THE CHAIRMAN: Now, this is your proposed amendment, and as I understand it you are trying to obtain through Mr. Fairweather an answer to the question whether or not the Canadian National Railway agrees with that amendment and will support it.

MR. EVANS: That was not the form of my question.

THE CHAIRMAN: Don't you think it is premature to ask that question today?

MR. EVANS: May I put this --

THE CHAIRMAN: You see it is a most important question, and of course it would be greatly to your advantage for you to secure the concurrence in the amendment of the Canadian National Railways, but I doubt whether this is the way to go about getting it.

MR. EVANS: May I put it this way? There were one or two places in the transcript when I was cross-examining Mr. Cooper when I thought your lordship thought I should have an answer to some of these questions before my cross-examination was finished.

THE CHAIRMAN: Certainly but mind you this is not a matter of evidence. You are asking -

MR. EVANS: The official position.

THE CHAIRMAN: - at this stage of our proceedings to know whether or not the Canadian National Railways will agree with you in presenting this amendment.

MR. EVANS: I did not put my question that way.

MR. O'DONNELL: This particular amendment has come in since Mr. Cooper was in the box, too.

MR. EVANS: I think it would have been unfair to ask Mr. Fairweather who, who with all regard to his professional capacity is a lay witness as regards legal problems - I think it would have been unfair of me to have put to him whether the Canadian National supported that particular legislation, but the terms in which I put my question were, would the Canadian National, as a matter of principle, support legislation that would guarantee --

THE CHAIRMAN: That is the same thing.

MR. EVANS: Oh, no, sir.

THE CHAIRMAN: I think it is all the fairer to him to read the amendment because then he knows exactly what you have in mind. You are entitled to ask Mr. Fairweather any question which he is capable of answering but if your main objective is to find out whether this other company is going to agree with you --

MR. O'DONNELL: My further point is, whether we concur or not, this submission is made to the Commission and the Commission is going to decide the thing. It will recommend this or not no matter how we may feel. After all, there are 14,000,000 shareholders who have a vote on the Canadian National. This is a matter where the board might have to adopt a formal resolution before it got into casting any votes. For forty years Section 325 has stood on the statute books, and it simply says just and reasonable rates. It has been interpreted as

just and reasonable and fair to shippers and to railways, and all railways. There was no one named road in the section, and it occurs to me my friend is a little perturbed, and possibly unnecessarily perturbed, but in any event, getting back to the question to Mr. Fairweather I submit it is premature, and it is a matter that in the final analysis could be dealt with on argument. What difference does it make insofar as the Commission is concerned whether or not Mr. Fairweather would support it?

THE CHAIRMAN: Are you prepared to say today, since this discussion has been precipitated, Mr. O'Donnell, whether your Company does or does not support this amendment?

MR. O'DONNELL: Well, I think I would prefer to leave it until a later stage, my lord. I think Mr. Evans has got a little too enthusiastic about certain things.

THE CHAIRMAN: The only thing I can see is that he is anxious to have Mr. Fairweather say this amendment should be supported by your Company. Is that your idea?

MR. EVANS: What I want to get is a declaration of policy from the Canadian National, but not particularly with regard to the wording.

THE CHAIRMAN: I think myself you are premature.

MR. O'DONNELL: I agree, and I think it should be dealt with that way.

MR. EVANS: May I put this to you, at page 18616 you, sir, put to Mr. O'Donnell --

MR. O'DONNELL: I will dispose of the matter. I would have preferred to have left it on the basis that it was premature but I will say no definitely, that we will not support legislation in that particular form as

proposed by that amendment. There are many reasons for that decision and those we can argue in due course.

THE CHAIRMAN: Now then, you are told now by the other company that they will not support your amendment. Do any questions arise of Mr. Fairweather after that?

MR. EVANS: Might I follow this up? I am not going to ask Mr. Fairweather that question again. I have got the official position of the Canadian National. I assume that my friend's answer is related not only to the amendment in the form in which it is put but also to the principle of it. If my friend would go that far --

MR. O'DONNELL: I am not going to be cross-examined about it. I have said we will not support the amendment as suggested by way of legislation. If there is another amendment and if the spirit or letter of the other amendment is something that is different, one might have to look at it. Then in due time we will consider it and give an answer again, but as to this particular amendment as proposed by my friend concerning Section 325 I am instructed to say we will not support it by way of seeking legislation.

MR. EVANS: Perhaps I could go on with what I had intended to put to your lordship. At page 18616 of volume 99 of the proceedings you put a question to Mr. O'Donnell as to whether they intended to meet the objection taken in our brief, and you gave the page reference to it.

Mr. O'Donnell said:

"I think we will have to discuss that."

You, sir, said:

"Mr. Walker, I think too, mentioned that. You intend to deal with that?"

Mr. O'Donnell: Oh, I think we will have to meet

"that and explain it, and give what information we can to help the Commission.

The Chairman: I mean, do you want to meet it now?

You are not going to wait till somebody raises it again?

Mr. O'Donnell: Oh, no, I do not think so, my lord."

That was on March the 20th. It is almost a month ago, and I thought it was not unreasonable to ask at this stage for some statement of policy. I have not been able to get it.

THE CHAIRMAN: You have it so far as this amendment is concerned.

MR. EVANS: Yes, and all I have is an objection to the form of the amendment but nothing on the question of principle, as to whether the principle I am talking about -- and I am not concerned with language; I am concerned with principle --

THE CHAIRMAN: Your position is this, that the Railway Act in the future should contain a provision that the Canadian Pacific Railway is to be the yardstick?

MR. EVANS: No, sir.

THE CHAIRMAN: Well, about that.

MR. EVANS: That we must at all events have a fair return on our investment.

THE CHAIRMAN: To serve your needs.

MR. EVANS: Yes. I am quite prepared to leave that subject and go on.

THE CHAIRMAN: We will take a few minutes' recess.
-- Recess.

THE CHAIRMAN: Mr. Evans, before we go on, would you be so kind as to let me see that a moment? You have only the one copy?

MR. EVANS: That is all I have in my book. Copies went to the Secretary on the 11th, I think.

THE CHAIRMAN: You will get some copies for us?

MR. EVANS: Yes. I want to make quite clear to your lordship and to the Commission that in asking my friends for a declaration of policy I am not asking them to commit themselves to language but only to principle and my thought is that after a month has gone by since the exchange with Mr. Cooper when your lordship was kind enough to suggest that some declaration of policy was required, that perhaps my friends would have arrived at the time when some declaration could be made and I thought before I left this matter of cross-examination that perhaps the Canadian National would have arrived at the point where on principle - not on language but on principle a declaration could be made.

Now, I am not going to pursue that at any great length.

THE CHAIRMAN: You are not giving up hope on account of anything that has been said so far?

MR. EVANS: Well, I would feel very badly if I thought I had to give up hope.

THE CHAIRMAN: Well, Mr. O'Donnell has told us so far that his Company does not agree with this particular amendment.

MR. EVANS: No, but he has not stated the principle he would support.

THE CHAIRMAN: I do not think you can crowd

them into saying anything about that today. I doubt whether the time has come to put that question to Mr. O'Donnell.

MR. EVANS: I did not put it originally to Mr. O'Donnell; I put it to the witness.

THE CHAIRMAN: Even the witness. I do not see how he can indicate the railway's stand.

MR. EVANS: I thought they were here to engage the railway on matters of principle.

MR. O'DONNELL: You have asked the railway and the answer is no and whether you get it from me or Mr. Fairweather the answer is no on that amendment. As to the rest, my friend says: "Well, we have been a month away and we thought we would have some declaration on this matter of principle."

Well, Mr. Fairweather has said that the Canadian National agrees that the Canadian Pacific should be as a railway maintained in a healthy condition in the interests of the country and so on and about this other statement of principle, I think it should suffice my friend so far as I am concerned, bearing in mind further that the Canadian National has not asked to be made the yardstick, has not asked that what has heretofore prevailed should be changed, and has agreed that the Canadian Pacific is doing excellent work in the transportation field in this country and should be kept in a healthy position so to do. What more my friend wants, I do not understand.

MR. EVANS: I want to make one statement and then leave it, sir. If that is the view of the Canadian National, then I ask them what kind of legislation are they prepared to support to make that possible because, as I have said to your lordship, if the Canadian National is to have

this relief - and I am not suggesting for one moment that under proper protection they should not have it - if they are to have it in future, not because of their ill will, but because of public pressure that may come, it may have this effect on the Canadian National - what kind of protection do they suggest should be given?

MR. O DONNELL: Well, all I would say in reply to that, my lord, is that we are not advising the Canadian Pacific as to how they should take care of themselves. They have administered effectively through the years when they knew what to do and when to do it .

Now, insofar as the Board of Transport Commissioners is concerned under Section 325 of the Act which is that just and reasonable rates - and they have been fixed on the basis of reasonableness - that just and reasonable rates should prevail. The Canadian Pacific has through the years except for the last short while when there has been this lag in getting an adjustment to meet the increased cost, have been given rates that have kept them in the healthy position that they were able to carry on their work in the transportation field. Now, this amendment which I said we would not agree to, as your lordship will notice, is quite a departure from what has heretofore prevailed and I would draw the attention of the Commission to the last paragraph of the amendment, 7, which puts the matter on an entirely different basis as to the fixing of the rates from what has heretofore prevailed. That amendment would put the fixing of rates on a rate of return basis - something that has not as of this date ever been applied in Canada. Heretofore it has been on the basis of requirements.

THE CHAIRMAN: It is a double provision.

MR. O'DONNELL: Oh yes, and maybe more than double. But we have not any objection and we have said it and for the purpose of terminating this discussion we have said that the Canadian Pacific Railway should be maintained in a healthy condition and should be allowed to do the work that they have done very excellently in the transportation business, and having said that, I am not agreeing with them in displacing that which has heretofore been done. As I have said before, the Board has the rates under control and what more do they want us to do.

THE CHAIRMAN: Then, are you now prepared on behalf of the Canadian National Railway to say that you are not supporting any legislation on this question at all and that you think this Section 325 should remain as it is? Now, if you do not feel like answering today don't.

MR. O'DONNELL: Well, I personally would have my answer quite ready but I think, in the circumstances, I will discuss it with my principals. All I was saying was that that particular amendment we would not support.

THE CHAIRMAN: Now then, their particular amendment says:-

"Rates shall not be deemed to be just and reasonable unless, taken as a whole, they are sufficient to provide a fair return upon the investment in the Railway property of the Canadian Pacific Railway Company."

Then it goes on:-

"And the Board may from time to time determine the investment in railway property upon which the return is to be calculated and the rate of such return."

Thank you Mr. Evans

MR. EVANS: Then, if I may proceed, Mr. Fairweather, do you believe that the Canadian National should be allowed to earn a reasonable return on a reasonable level of its railway property investment?

A. Well, that is rather an academic question when you look at the investment in the Canadian National Railways, and if you mean by "reasonable return" a commercial return.

Q. In order to not get at cross-purposes, perhaps I can refer you to a series of questions I put to Mr. Cooper. First, I asked him, based on a statement he made prior to the beginning of my cross-examination, whether he had any views in general terms as to what the returns should be, and he explained to me that if you were to take in the whole of the equity capital of one billion eight he thought the return should be at least twice what Exhibit 240 shows - $3/4$ of 1%, and possibly higher, and I think that is a fair statement of what he said.

Then, I asked him whether, in view of the special circumstances under which the Canadian National was operating, he would prefer in the event of a return on investment being applied as a principle, to have the investment basis on which the return was to be calculated reflect these special conditions or whether the rate of return should reflect these conditions, and Mr. Cooper expressed a preference to have the adjustment in the investment base, and not in the rate of return.

Then, I asked him - -

MR. O'DONNELL: Do you remember what page that was, Mr. Evans?

MR. EVANS: I can look it up. I think I am

being quite fair with him. I asked him what would happen in you had got the investment base adjusted and he said:- "Then, we should have a commercial return the same as your Canadian Pacific Railway" - I think were his words.

Now then, having regard to that, I ask you whether and under what conditions you believe that the Canadian National should be allowed to earn a rate of return on a reasonable level of its railway property investment.

A. Well, frankly I have never thought of the problem in just those terms.

MR. O'DONNELL: May I interrupt, Mr. Evans? Would you be good enough to tell me where that is?

MR. EVANS: There is no doubt about the accuracy of my statement.

MR. O'DONNELL: I do not doubt that, but you have paraphrased it and I would just like to check the context.

MR. EVANS: You will find it on page 18926 and this is what I find there. He felt that the return on equity capital, and that was the whole equity capital, should be at least the same shown by Exhibit 240, that is, $\frac{3}{4}$ of 1% and he said it should go even higher than that and then, at 18933 he said:-

"We would have to set aside a substantial amount of the investment as not entitled to rank in the base for rate of return purposes." And then I asked him this question:-

"Then, what was left in the base could be treated as a commercial company would treat it and the rate of return would be the commercial rate of return?

A. It would be a comparable basis with your Canadian Pacific Railway."

Do you see that, Mr. Fairweather?

A. I do not know that I did succeed in finding all of those references, but would you mind restating your question to me that you want me to answer?

Q. The question I asked of you, was whether you believed that the Canadian National should earn a reasonable return on a reasonable level of its railway property investment?

A. Well, what is a reasonable investment and a reasonable rate of return if you assume that the Canadian National is to part of the rate base is a matter which I consider to be for the determination of the Board of Transport Commissioners. That is, it would be within their field to fix what is the reasonable capital upon which a return may be earned and it would also be up to them to determine what would be a reasonable return, and I do not see that any off-hand estimates that I might give on that matter would be very helpful. It is a very complicated matter indeed and if the rate base was ever extended to the Canadian National Railways, the Board of Transport Commissioners would be forced, in my judgment, to consider those two factors - how much of the capital invested in the Canadian National Railways is entitled to a fair rate of return and, second, what should that fair rate of return be?

Now, there is a great deal of capital shown in the balance sheet of the Canadian National Railways as investment in road and equipment that, let us say, is of one category, and other investments is another. Take the investment in Canadian Government Railways. Take the stated investment in the Newfoundland Railways and

all those sorts of things - all matters like that would have to receive consideration, and I have no doubt they would receive consideration. That is what I referred to when I said that to make the Canadian National Railway the rate base for Canada it would certainly require a great deal of study. The Canadian National submission is purely one to enable it to operate with managerial efficiency because we have a target to shoot at that we have some hope of making a favourable score with.

Q. Now, I am sure it is as much my fault as it is yours, Mr. Fairweather, but I did not ask you either whether the Board should do this, because I think it must be the Board, or what the return or the base should be - I merely asked you whether you believed that the Canadian National should be allowed to earn a reasonable rate of return on a reasonable level of its railway property investment.

A. And I think I answered your question, sir.

Q. Do you answer "yes" or "no" or what is your view?

A. Well, I remember one of your witnesses saying that there was a lot of questions he could not answer "yes" or "no" to.

Q. Then, do I take it that you have no fixed opinion which would enable you to answer "yes" or "no" to that question?

A. I say that it would require a great deal of study and I think the Board of Transport Commissioners is the competent body to make such a study and off-hand any opinion I might have at this stage would add nothing to the discussion.

Q. Do I take it then that the Canadian National through you or its other officers would not be urging the Board to find some base, whatever that might be and a rate

of return, whatever that might be?

A. We have already said that we are not asking to be made a rate base. We are asking to have our capital structure reduced.

COMMISSIONER INNIS: Do you think it makes very much difference what the Board says if you leave out of consideration the whole problem of wages and labour?

A. Well, it is all inter-related, sir.

Q. Well, if the whole question as to the wage bill is to be determined outside the Board?

A. Well, the whole matter becomes a very complicated one, I admit, and the way it works at the present time is that the railway negotiated with labour and to that extent determined requirements and then went to the Board and presented these requirements and said:- "Here are the requirements including labour".

Q. Labour did not go to the cabinet to get a wage increase?

A. You mean the Government?

Q. Yes, was not there 17¢ increase as a result of the intervention of the Government?

A. Well, a 17¢ wage increase was given, yes, certainly, and I know that in that case the Government or members of the Government acted as intermediaries in the negotiations, but I do not know exactly the form that that took.

MR. O'DONNELL: You weren't there, Mr. Fairweather?

A. I was not there, no.

COMMISSIONER INNIS: I am just a little fearful of some unrealistic elements coming into the whole discussion.

MR. O'DONNELL: Might I ask this, Dr. Innis?

I think you have given an indication of that question on several previous occasions, and the first time, I am frank to say, I did not quite catch the implication of the question. As I understand it now, and I would be glad if you would indicate whether my understanding is correct or not, your thought is that so long as wages, a very important element in operating costs, are fixed by somebody by their negotiations, that the Board has no control of and that they must be made by increased rates, that the Board is forced in the circumstances to follow the outcome of these negotiations and whatever outcome there might be and that there should be a closer tie-in?

COMMISSIONER INNIS: I think it is a little unrealistic to include the whole position of labour and not to realize that the Board after all is probably more concerned about this than about any other item.

MR. O'DONNELL: That is a major item usually in all these increases.

COMMISSIONER ANGUS: If one were to ask what level of rates would be just and reasonable so far as the Canadian National Railways is concerned, is the only answer that can be given "That level of rates which the Board of Transport Commissioners may determine is just and reasonable for the Canadian Pacific Railway"?

A. That has been the practice for these many years.

Q. And that is how you think of it?

A. That is how our forecasts have certainly been worked out as to what our results would be and this revision of the capital structure was certainly related to an expectation of an earning position in the future adjusted to conditions in the future similar to what had been in the past and that obviously was a rate structure determined by the requirements of the Canadian Pacific. (20287 follows)

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MR O'DONNELL: Although I draw attention of the Commission to the fact---

THE CHAIRMAN: Pardon me. You are using the word "requirements" there. What is the difference between that word as we have heard it commonly used and the language expressed by Mr. Evans in his proposed amendment?

MR O'DONNELL: Well, there are two different ways of fixing rates. The one is on the requirement basis, which has prevailed in Canada heretofore, and the other as now suggested by this amendment would be on a rate of return basis, upon a property investment account that would be regarded as the rate base, and they are two different ways of fixing rates.

THE CHAIRMAN: Yes, but how does the requirement principle operate?

MR O'DONNELL: Well, the requirement principle has operated heretofore by the railways going before the Board and saying, "We need our operating costs, we need rates that will allow us our full operating costs, our interest on borrowed moneys, a reasonable dividend and a reasonable surplus or additions and betterments." That is the way they have been fixed heretofore. In the 21% Case, as I remember it -- I have not looked at this particular aspect of it for some time -- while the figures of the Canadian Pacific were taken into account, as I remember it, the Chief Commissioner did say that some regard had to be had for the other railways -- there are eighteen or nineteen of them who applied for rate increases, although the two major railways do handle about 98 per cent of the traffic, but they did not entirely disregard the effect that the increase would have on the other roads as well, although in this latest case the figures of the Canadian Pacific were taken and the judgment was based in that case solely

on those figures.

THE CHAIRMAN: Now, for the future does your company intend to tell us which principle ought to be applied by the Board?

MR O'DONNELL: Well, at this point, and subject to further instructions, my view is that section 325, the section under which the rates are fixed, is broad and wide enough to allow the Board to fix rates on whatever basis they think is the right way to do it. They are free to fix it on a rate of return.

THE CHAIRMAN: Either on the basis of a return on investment---

MR O'DONNELL: Or on requirement. They are absolutely free, and they can take the rate of return base or theory if they wish to. Our friends suggested during the last case that they had established a rate base and that the rate should be determined upon a rate of return. The Chief Commissioner said that he could not agree---

MR FRAWLEY: Your friends -- you mean the Canadian Pacific?

MR O'DONNELL: Yes; the Canadian Pacific had asked that the rates be established on a rate of return basis, but the Chief Commissioner said that he could not agree that a rate base, a satisfactory rate base, had been established, as the provinces refused to acquiesce in the suggestion, and the rates were fixed as they had been before. Your lordship will find at page 14 of the judgment of the 20th of September, 1949 -- that is the 8% judgment -- the discussion regarding rate base and rate of return, and at the top of page 15 the learned Chief Commissioner said:

"However I do not believe that such considerations justify me in determining without further evidence and investigation that the investments have been prudently

made, and that the revenues have been sufficiently accounted for. Notwithstanding, therefore, the very able and learned arguments advanced by counsel for the Canadian Pacific Railway and notwithstanding the evidence of the learned experts, I accept the arguments advanced for the Province of Saskatchewan and the Maritime Transportation Commission that much more evidence than that adduced will be necessary to justify this Board in deciding that from this exhibit and the evidence in its support a rate base had been established for the purposes of dealing with this application."

He did not agree that there had been a rate base established, and fixed rates on the basis that they had previously been fixed on. But under section 325 the Board is quite free to adopt either way.

THE CHAIRMAN: Yes, I know, but does your company take the attitude that the Board should be left free?

MR O'DONNELL: Yes.

THE CHAIRMAN: That there should be no principle put into the Act for its guidance?

MR O'DONNELL: Well, we have made no suggestion for an amendment of that section. We think the section is satisfactory, and we think that it is better that the Board should be left unfettered in the matter of making rates and of making them on the basis that they are fair and reasonable as they have heretofore, with the result that the railways have been able to live.

COMMISSIONER ANGUS: On what principle does the Canadian National Railway act when it decides whether or not to support a request for a change in the level of freight rates by the Canadian Pacific Railway? Does it simply look at the Canadian Pacific balance sheet and

accounts and say, "Is that railway earning enough? If not, we will support them," or does it look to its own requirements in some way?

MR O'DONNELL: I think it looks to its own requirements. When the operating people come in and say wage rates have gone up 17¢ an hour, that is so many millions of dollars -- \$39,600,000 was what the 17¢ meant -- then the management decides that it needs an increase.

COMMISSIONER ANGUS: But if it looks to its own requirements how does it define those requirements?

MR O'DONNELL: How does it define requirements?

COMMISSIONER ANGUS: Yes.

MR O'DONNELL: Well, in that particular case I have in mind, the only instances where they have had to apply for rate increases in the last three or four years, they have been directly tied to operating costs, increases in material prices and increases in labour costs, and on the basis of those changes in operating costs they have said, "We need a rate increase of so much."

COMMISSIONER ANGUS: But operating costs plus their fixed charges.

MR O'DONNELL: Well, the fixed charges -- how they spend the proceeds of the rate once they get it is another matter, but as to the operating costs I say that our application for increased freight rates in the last two cases in which I was concerned was based on those two simple facts -- operating costs, that is, wages and material prices, have so increased, to the extent of X dollars, that we need an increase in freight rates that will give us those increases or offset them.

COMMISSIONER ANGUS: The effect of that would be to preserve your surplus over those increases at whatever it was before.

MR O'DONNELL: Well, as Mr. Fairweather and Mr. Cooper have said, we never have had to worry very much over surpluses over the last twenty-five or twenty-six years, except in the war years.

COMMISSIONER ANGUS: Over your operating costs.

MR O'DONNELL: That is right.

COMMISSIONER ANGUS: You have had those.

MR O'DONNELL: Just in the war years, really -- once before, I think.

THE CHAIRMAN: In any case, the two railways did agree and had to agree on the percentage of increase that you wanted.

MR O'DONNELL: Well, the percentage of increase, I think, although I was not in on the---

THE CHAIRMAN: For instance, you asked for 30 per cent; that must have been by agreement between the two companies.

MR O'DONNELL: Well, we said 30 per cent would be what we need to offset these increases that we have experienced and which have changed our position from what it would have been if the increases in cost had not taken place. I assume there were discussions; I was not---

THE CHAIRMAN: Was that figure arrived at by that Freight Association or whatever you call it?

MR EVANS: No; the Railway Association of Canada is the nominal applicant, not the Freight Association. The Railway Association of Canada is the nominal applicant on behalf of its member companies.

THE CHAIRMAN: That includes both of you?

MR EVANS: It includes both of us, and a number of others, I think eighteen or twenty smaller railways.

THE CHAIRMAN: Well, you see, in the result you arrived at the same figure; of course, you had to.

MR EVANS: Yes.

THE CHAIRMAN: And I think that is some sort of answer to Dr. Angus's question there as to how the C.N.R. arrived at their figure. Do they say the C.P.R. needs so much, 30 per cent---

MR O'DONNELL: As I say, I was not at those meetings, and I don't know that even if I had been I would want to be telling all my friends here how we deliberated and arranged all those matters.

THE CHAIRMAN: Has this been the case not only in the matter of these recent applications but in former applications too, that both your companies have agreed on the figure of the increase required?

MR O'DONNELL: Well, my lord, maybe Mr. Evans can answer that. I only started in 1948. The last increase before that was a little earlier in my history than----

THE CHAIRMAN: A long time ago.

MR O'DONNELL: Yes.

MR EVANS: I only recall one case in the history where the two railways did not ultimately get together and agree on the percentage of increase.

THE CHAIRMAN: When was this?

MR EVANS: This I think was in 1916 or so, when the Grand Trunk, I think, made an application in which the Canadian Pacific did not join. My friend will perhaps correct me on that -- yes, 1916.

THE CHAIRMAN: But ever since then you have agreed on a figure to present to the Board?

MR EVANS: Yes.

MR FRAWLEY: A very effective combine.

MR EVANS: My friend can talk about combine, but at all events he has saved himself a good deal of money by his activity, and I suggest that he has not yet paid us

enough.

MR FRAWLEY: From now on we are going to pay you all the time, it seems.

MR EVANS: Now, I would like to make just one little statement about this question that my friend Mr. O'Donnell mentioned. I may say that I am inclined to agree with him, that the Railway Act as it stands does permit the Board to take into account return on investment.

(Page 20295 follows)

But I am quite frank to say this, that with the questions which have arisen with regard to apportionment of fixed charges and dividends to get to a formula, and with the changes in the requirements of the Canadian National which would come if it does go through, the proposals they now make, it seems to me that we must ultimately come to one system only, and that is a rate of return.

The reason I say that is this. If you are on that basis it does not make any difference what your fixed charges are, what your equity capital is; it means only that you must out of a return on your investment service your capital requirements and provide yourself with a surplus. All these questions, the capital structure of the Canadian National, the apportionment of dividends and fixed charges of our Company would perhaps be solved by going to a rate of return and nothing else for ratemaking. For that reason, although I think the Board has now the option to do that, and for the further reason that our friends, whether or not they are now prepared to take the position, did take before the Board the position that you had to have an evaluation, I suggest that we ought to get this thing clarified in some form, and we make that suggestion in the hope of clarifying it.

Q. Now then, Mr. Fairweather, I am sorry to be so long with you. Now, whatever we may say about the possibility of the Canadian National earning a surplus -- I do not want to engage you in that discussion at the moment; I am going to come back to it -- leaving aside whether or not you are right or wrong on whether the Canadian National may earn a surplus, what, in view of the withdrawal of the provision in Mr. Gordon's statement regarding surplus funds, is the intention of the Canadian National as to the use to be made of any surplus earnings it may make?

A. It would use them for such corporate purposes as the board of directors thought proper to use them for, I would take it, and within the limits of our act.

Q. Then, is it a part of your present intention in connection with these proposals that whatever the surplus may be, no matter how large or how small, it is to be retained by the Company for its corporate purposes?

A. Oh, I couldn't say that.

THE CHAIRMAN: Q.What did you say?

A. I say I couldn't say that because the legislation that governs our board of directors in this matter provides that the directors may retain the earnings but it also directs the board of directors to consider the paying over of surplus earnings to the receiver general.

Q. What legislation are you referring to?

A. The refinancing act.

MR. O'DONNELL: The Capital Revision Act.

THE WITNESS: The Capital Revision Act of the Canadian National Railway.

MR. EVANS: Section 10.

MR. O'DONNELL: Yes. All I would say there is that Mr. Fairweather is a man of many talents and many things but how my friend can expect him to prophesy what the board of directors may do this year or ten years from now or five years from now is something I don't think he can do, and I don't think again that he should be asked even to venture an opinion on it. I certainly would not undertake to ask my friend what his board of directors might do at some time under certain circumstances within the powers that the law gives them.

THE CHAIRMAN: I should like first to have the legislation before me.

MR. O'DONNELL: Section 10 of the Capital Revision

Act. It is 1 George VI, Chapter 22.

THE CHAIRMAN: What year is that?

MR. O'DONNELL: 1937.

THE CHAIRMAN: It is Section 10 of this Act.

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: I see that it reads:

"Whenever the accounts of the National Railway System as certified by the auditors appointed by Parliament show surplus earnings after the payment of all charges including interest on securities held by the public, the directors of the Canadian National Railway Company may cause to be paid over to the Minister for the Consolidated Revenue Fund all or any part of any such surplus earnings."

That is the law as it now stands.

MR. O'DONNELL: Yes, and we have not asked for any change in it.

THE CHAIRMAN: You wish it to be left that way. Have you anything to say about that now?

MR. EVANS: I ^{was} asking the witness what the proposals would envisage doing with surpluses if they should occur.

THE CHAIRMAN: The proposal concerning the capital structure.

MR. EVANS: Yes, sir. Is it their intention that it shall be solely for the board of directors to say whether any part of the money is payable to the government as the owner of the equity capital, or is there to be some guarantee that the government shall have a return out of any surplus?

MR. O'DONNELL: I object to the question as put and say it cannot be answered by this witness. I further

draw attention to the law which is clear. In so far as the law is concerned it operates in the same way as the law governing my friend's company. His board of directors decides what to do.

MR. EVANS: I can only take from what my friend says that he is not prepared -- and I gather this is his answer to your lordship's question on March 20th -- to take the position that the Canadian Pacific should have some guarantee that the reduction of the fixed charges of the Canadian National shall not be accompanied by some assurance that the equity capital shall be permitted to earn a reasonable return. That was page 109 of part I of our submission. The position we took there was :

"...Canadian Pacific would be deeply concerned in any reduction in the fixed charges of Canadian National unless the principle is recognized that Canadian National should be permitted to earn a reasonable return on a reasonable level of railway property investment."

Then at the end of paragraph 55 on the same page we say:

"A reduction in the amount of the fixed charges of Canadian National, unaccompanied by some statutory assurance that its permissible earning power as a railway would not thereby be reduced, would offer a serious threat to the ability of Canadian Pacific to continue to function as a privately owned railway system."

Really what I am trying to get from Mr. Fairweather, because he is one of the senior officers of the Company, is what assurance, if any, accompanies the recapitalization proposals that the equity security holder, the government, shall have paid to it some return on the equity investment

in the Canadian National. I would have thought that was a fair question either for this witness or for somebody from the Canadian National.

THE CHAIRMAN: You relate it to the question of the disposal of the surplus which the company may have.

MR. EVANS: Yes, because that is after all the only return it can get.

THE CHAIRMAN: At the present time Section 10 simply says that after they have paid all their liabilities then they may cause to be paid into the consolidated revenue fund all or any part of such surplus. There is no direction as to what they will do with the rest. That is what you are concerned about.

MR. O'DONNELL: I point out that my friend's company is in exactly the same position.

THE CHAIRMAN: That may be. We are bearing that in mind but we want to know now what Mr. Evans' concern is about this.

MR. O'DONNELL: I don't know what his concern is.

THE CHAIRMAN: We cannot know until he tells us.

MR. O'DONNELL: I thought he had tried to tell it.

THE CHAIRMAN: We are only going to know through his questions to the witness. We will adjourn now.

--- The Commission adjourned at 4.50 p.m. to resume on Friday, April 21, 1950, at the hour of 10.30 a.m.

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ROYAL COMMISSION
ON
TRANSPORTATION

EVIDENCE HEARD ON

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
FRIDAY
APRIL 21, 1950

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN

HAROLD ADAMS INNIS - COMMISSIONER

HENRY FORBES ANGUS - COMMISSIONER

G.R. Hunter
Secretary

P.L. Belcourt
Asst. Secretary

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H.C. Friel, K.C.		
C.F.H. Carson, K.C.	}	Canadian Pacific Railway
F.C.S. Evans, K.C.		
K.D.M. Spence		
I.D. Sinclair		
C.W. Brazier)	Province of British Columbia
J.J. Frawley, K.C.)	Province of Alberta
M.A. MacPherson, K.C.)	Province of Saskatchewan
C.D. Shepard)	Province of Manitoba
J. Paul Barry)	Province of New Brunswick
Frank D. Smith, K.C.)	Province of Nova Scotia

Ottawa, Ontario,
Friday April 21, 1950.

M O R N I N G S E S S I O N

MR. EVANS: At the adjournment last evening, my lord, I had been about to give to your lordship and the Commission, in response to ^asuggestion by the Chairman, exactly what my concern is. Your lordship will remember the words, "We cannot know until he tells us" were among the last expressions. There seems to be some impression that the withdrawal of the paragraphs in Mr. Gordon's statement having to do with surplus earnings is in some way a removal of the objection which we have expressed in the Brief and the concern which I from time to time have expressed throughout these proceedings. I venture to express respectfully to the Commission, and with the greatest deference to my friends, that the terms in which the withdrawal was made make it quite clear that all that is being done is that that portion of the statement of Mr. Gordon is to be deleted and treated as if it had not been contained in the statement. Your lordship will find that at the beginning of page 20024 and continuing over a couple of pages. At the bottom of the page, - and this is page 20025 - after the Chairman had said to Mr. O'Donnell, "You do not want any recommendation", we find this:

"THE CHAIRMAN: You do not want any recommendation?

MR. O'DONNELL: No recommendation.

THE CHAIRMAN: The Board will be left free as it is today.

MR. O'DONNELL: Under the Statutes as they stand today."

THE CHAIRMAN: Is that the Board of the C.N.R.?

MR. EVANS: That is the Board of the C.N.R. he is speaking of, because the next statement of Mr. O'Donnell speaks of the Board of Directors. What I am suggesting to the Commission is this. The mere removal of the provisions with regard to surplus, while leaving the matter lacking in clarity at least as to the disposal of the surplus, leaves it as I suggest in a position where the Canadian National could do with its surplus funds exactly that which this original submission by Mr. Gordon indicated was part of its submission. In that light there is no real difference in my basic concern.

I go this far with my friends, that the use of the phrase "rate stabilization fund" in the context in which it was used and in the terms in which it was used, in itself provides some difficulty, and to that extent the situation may be considered to be improved. But bearing in mind that my prime interest is not that the Canadian National should not be relieved but that if they should have large surpluses there should be some way in which it can be made necessary that those large surpluses should not all be left in the hands of the Canadian National so as to bring about a pressure to make them the yardstick for rate making and to take into account after this recapitalization has been forgotten in the minds of the public, "Here are large surpluses which ought to be applied in the reduction of freight rates." I am trying to be fair to my friends, but the position is almost exactly the same as if those paragraphs in the submission had not been removed. That is why, your lordship, I was putting to Mr. Fairweather

yesterday just before the adjournment a suggestion that he should indicate the policy which the Canadian National intended to follow with regard to the use of any surpluses it might have.

THE CHAIRMAN: You are, of course, bearing in mind Section 10 of the Act.

MR. EVANS: My friend takes the position that that permits the Directors to retain surpluses or pay them over, as they may choose. My hope would have been that that word "may" might be changed to "shall", with some qualification so that they may be allowed to keep some of the surplus for this non-revenue producing portion.

THE CHAIRMAN: You think it should be taken in, not amended?

MR. EVANS: Yes.

MR. O'DONNELL: Before we get to that point, may I say that as the Section stands today it applies to the Board of Directors of the Canadian National, and they are in the identical position of the Canadian Pacific Railway Board of directors. Why there should be any change in that position I do not know. Furthermore ---

THE CHAIRMAN: Pardon me, I understand what you mean, but what you said is not altogether accurate, because Section 10 says that you may cause to be paid over to the Minister.

MR. O'DONNELL: Yes.

THE CHAIRMAN: For the Consolidated Revenue fund all or any part of such surplus earnings.

MR. O'DONNELL: Yes.

THE CHAIRMAN: There is no such provision for the Canadian Pacific.

MR. O'DONNELL: When the Minister is referred to,

the Minister is in an analagous position to that of the shareholders of the C.P.R. The shareholders of the Canadian National are represented by the Minister. Therefore Section 10 provides for payment to the shareholders of the Canadian National of any surplus there may be, just as the Directors of the Canadian Pacific are free to pay their shareholders any surplus there may be.

THE CHAIRMAN: The shareholder in your case is the Government of Canada?

MR. O'DONNELL: It is one shareholder, the Government of Canada. The people of Canada own the railway. The Directors are appointed and given the same power as the Directors of the C.P.R. with respect to surpluses. My friend's suggestion is that the Board of Directors of the Canadian National should be put in an inferior position, that they are going to be rubber stamps, and that they are not to be allowed to use their good judgment as to how the railway should be administered in the event that there might be a surplus. Mr. Fairweather and Mr. Cooper ^{have said} as to the possibility of surpluses in the future - and they speak with the experience of 30 or 40 years - that by the set up which they are proposing should be recommended, they think in some years there may be a surplus, but that on the average they will just about be able to break even. That is their assessment of the surplus position. But whether or not that be an absolutely accurate forecast, why should the Directors of the Canadian National be put in an inferior position with respect to using their good sound judgment as representatives of the shareholders, the people of Canada, as contrasted with the Directors

of the Canadian Pacific?

Your lordship will remember that when this discussion arose concerning Mr. Gordon's proposal with regard to surplus earnings, it was suggested that we might withdraw what was termed that "contentions" part of his submission. I acquiesced in that suggestion, or rather my client did. Your lordship's suggestion was that the Section be withdrawn. At page 18999 we find this:-

"THE CHAIRMAN: Would you go so far as to say - I know this question would require consideration and I don't want to force you into a snap answer - but would it be all right to withdraw this contentious part of Mr. Gordon's statement, and leave the Act as it is?"

That was the proposal.

THE CHAIRMAN: That did not mean to say to leave the Act as it is forever.

MR. O'DONNELL: No, not forever.

THE CHAIRMAN: That Act as it is now, is still subject to any objection to it that Mr. Evans may choose to take.

MR. O'DONNELL: Oh, yes, and he may object to it. I have no objection to his objecting to it.

THE CHAIRMAN: Mr. Evans is in the same position to make suggestions concerning Section 10 as if that paragraph had never been contained in Mr. Gordon's statement.

MR. O'DONNELL: Yes; and Mr. Evans said that he was asking for no amendment to Section 10.

MR. EVANS: Yes.

MR. O'DONNELL: That is the situation.

THE CHAIRMAN: He may have changed his mind.

MR. EVANS: No. As I said to your lordship when this matter was brought up, I am not concerned with Section 10 as such. I am concerned that the legislation which is going to be necessary to give effect to this should contain the direction whether you do it by an amendment to Section 10 or whether you do it by any other means. We have proposed one means, by an amendment to the Railway Act. I am not concerned particularly with Section 10. I am only concerned with getting some legislation emerging from this, because it is going to require legislation to do what is proposed. But I want to say this. My friend Mr. O'Donnell - and I am sure that he wants to be fair - says they want to be put in exactly the position of the Canadian Pacific. Let us look at that suggestion for a moment.

MR. O'DONNELL: I said our Directors. Let me correct my friend before he goes any further. I simply said there was no reason, in my view, why our Directors should be put in a position inferior to that of the Directors of the Canadian Pacific Railway. That is what I said.

MR. EVANS: All right. Let us accept that. statement, a position inferior to their Directors.

MR. O'DONNELL: With respect to using judgment.

MR. EVANS: The Directors of the Canadian Pacific have pressure on them to earn and to pay dividends to their equity shareholders. If they cannot do that, they cannot finance from their own

resources, except so far as they are able to have surplus funds; and if they have surplus funds, they are compelled, if there is sufficient, to pay a dividend. All I am saying is that the Government is the equity shareholder of the Canadian National, and the Government is not clamouring to the Canadian National as our shareholders are clamouring to us, to pay a dividend or to show a dividend.

MR. O'DONNELL: Oh, Mr. Evans - -

MR. EVANS: Please let me finish, Mr. O'Donnell.

MR. O'DONNELL: How can you say that?

(Page 20308 follows)

MR. EVANS: The commercial pressure, the financial pressure is on the Canadian Pacific to earn and pay dividends. If we can put the same kind of position for our friends of the Canadian National where there is pressure and need to earn and pay a return on the equity capital, I am content, but I do not want something to develop where the pressure is all the other way. We have no doubt in our minds, and I am sure the Commission has not in its mind, that when the government sees large surpluses held by the Canadian National there will be a tendency in a great many directions to say, "Why should the Canadian National have these big surpluses? Why should the freight payers put up these large surpluses? There ought to be a reduction in rates." I could not put it any more clearly than that.

MR. O'DONNELL: If I may be permitted to make a remark in respect of that, if we had these large surpluses to which my friend refers, based on the fact that they would be earned on rates that had been established on a yardstick such as is used to-day, which we have not asked to have changed, then for every dollar that we have our submission is they would have more. That is our submission, and we think we can establish that to the satisfaction of this Commission. That being the case why worry? Even if we did have surpluses, is it the suggestion that the government would idly stand by, the owner, the shareholder in our case, and allow the moneys to rest in the till of the Canadian National? There would be the same pressure on us, and that is the view of our management. The government would expect the moneys to be turned over. They would not allow the moneys to rest in the till. There would be the same pressure by shareholders, in our case the government, on

the management of the Canadian National for a declaration or payment of whatever there was, which in the case of the C.P.R. would be called dividends, and which in our case is referred to as surplus, to turn it over to the government. There would be the same pressure. The C.P.R. board of directors have to pay dividends to their shareholders, and in our case pressure would be placed upon us by the government. I say that for every dollar we would have they would have a dollar more.

THE CHAIRMAN: What form would that pressure take?

MR. O'DONNELL: The pressure would simply take this form. In the case of the C.P.R. if their board of directors would not declare dividends, having earned them, and having them available for any length of time, an annual general meeting or a special general meeting of shareholders would easily change the board of directors, and in our case our board of directors, if it was not meeting with the views of the only shareholder, could likewise be changed. The same parity of position is there in each case.

THE CHAIRMAN: Just a moment. You have one shareholder, and that is the Government of Canada.

MR. O'DONNELL: That is right.

THE CHAIRMAN: Do you think it would be proper to have a provision that the government might call on you at any time to hand over the whole or any part of your surplus?

MR. O'DONNELL: I think the government --

THE CHAIRMAN: They could anyhow.

MR. O'DONNELL: I think they can anyhow, yes. I say the act has been there since 1937, and any time there has been anything in the way of a surplus, and it was only

during those four war years, the surplus was used; it was not kept or held.

THE CHAIRMAN: I know that, but we must still bear in mind that you are now asking for a recast of your capital structure which you hope will have certain consequences. We must very carefully measure the result of those consequences on the C.P.R. and others concerned. I think the matter must be examined very, very carefully.

MR. O'DONNELL: I have no objection to it being examined very, very carefully. I am saying that my friend's suggestion that the directors of the Canadian National should be put in that inferior position where they are not allowed to exercise good business discretion and judgment as the directors of the C.P.R. are, is unfair and unreasonable.

MR. EVANS: I did not say that.

MR. O'DONNELL: And that there is no difference in the pressure in any event because the same pressure he can point to from his shareholders is there with respect to the pressure that can be put on our directors.

COMMISSIONER ANGUS: Is the suggestion not that the capital structure itself might provide a certain amount of pressure by indicating a sort of expected level of dividends?

MR. O'DONNELL: My answer to that is this, that I am instructed the situation would be that for every dollar the C.N.R. would have the C.P.R. would have a dollar more in ordinary years, apart from years such as the war.

COMMISSIONER ANGUS: Have you put that in reverse? Have you made any estimate of how great the Canadian National surplus would be if the Canadian Pacific were to get the rates necessary to give the rate

of return that it has asked for on the rate base it has put forward? Both those are in dispute, but I gather if it received the rate of return it thinks fair on the rate base it thinks proper that that would give a higher level of rates than to-day, and so to speak for every dollar they get you get one.

MR. O'DONNELL: We get less than they would.

MR. EVANS: They get twice as much, my lord.

COMMISSIONER ANGUS: Have you any idea what the magnitude of your surplus would be under those conditions?

MR. O'DONNELL: I have not made that exact type of computation.

COMMISSIONER ANGUS: It would not be very difficult to make.

MR. O'DONNELL: I do not think it would, but I do say that Exhibit 246, which is Mr. Cooper's computation of what the result would be if these adjustments we have asked for should be granted, shows a surplus of \$13 million; \$13 million on \$550 million worth of gross revenue, and on the extent of the business done by the Canadian National, is certainly not an excessive surplus. It is less than the item of additions and betterments which was considered in the 21% case, and which was regarded as being synonymous with the word "surplus" in so far as the C P.R. was using it. There were \$15 million or \$16 million taken into the computation for that one item alone.

COMMISSIONER ANGUS: If we do not use that hypothesis the result is very curious because the estimate given in Mr. Gordon's remarks is that the surplus would average zero over a period, and if it did that at the rates that were proper for the Canadian Pacific, then even if you project into the future, as Mr. Fairweather

did, and state with the development in population and so on you would expect larger earnings, the answer would be yes but those would be wiped out by lower rates because the C.P.R. is the yardstick so that would mean that you would almost have to look forward to surpluses averaging zero unless the relative position of the two railways is changed.

MR. O'DONNELL: Yes, that is true, unless the relative position changes we look forward to surpluses averaging zero.

COMMISSIONER ANGUS: It seems to me we are hovering between the hypothesis of surpluses averaging zero, and the hypothesis that Mr. Cooper indicated, namely, that a proper earning might be one and a half per cent on the equity capital. It is a little confusing.

MR. O'DONNELL: As I see it, there is no threat in our view to the Canadian Pacific whatsoever on the proposal set forward. It protects them amply, and our having done a little internal housekeeping and housecleaning in so far as the capital structure is concerned does not affect them one iota because they go to the Board of Transport Commissioners and the Board fixes rates that are just and reasonable not only to them but to all other railroads and to the shippers.

COMMISSIONER ANGUS: As I understand it there is no test of what rates are just and reasonable to the C.N.R., no criterion, no standard.

MR. O'DONNELL: I think the test is that the C.N.R. is only one element in the entire over-all picture that the Board must take into consideration. There are twenty different railroads and there are fourteen million people, some of whom are shippers, and the Board of

Transport Commissioners looks at the entire picture. Reference was made yesterday to section 325 which has stood the test of time for thirty or forty years. I have not looked up the exact date, but it has been on the statutes for a long time. Practically every word of it has been gone over and settled by litigation, and it is thoroughly understood by those who have to use and apply it. That is why I suggest it would be a dangerous thing, in our respectful view, to adopt Mr. Evans' suggestion with respect thereto.

COMMISSIONER ANGUS: If the Canadian Pacific is the yardstick that is one thing, but if all the railways of Canada are the yardstick that is another thing. If the suggestion is that rates must be just and reasonable to all railways, and the C.N.R. the biggest of them, does that not in itself bring in a sort of auxiliary yardstick, potential yardstick, if you like, some suggestion of measurement, some suggestion of fairness, and what does it amount to?

MR. O'DONNELL: In my view parliament has said that all that shall be determined by the Board of Transport Commissioners in the freest and most unfettered way possible. They are put there to determine what is fair to the country as a whole, to the shippers and to the railways, and through the years they have always seen to it that Canadian Pacific was allowed rates that let them live ^{the} vigorous and healthy transportation life that they led. We have not any doubt that the Board of Transport Commissioners is going to continue to see to it that that very important element in the transportation life of Canada is permitted to live with rates that are just and reasonable to them, to the shippers and to other

roads also. We have not any doubt about that, although they seem to have fears.

COMMISSIONER ANGUS: Have they also seen to it that other railways get adequate revenues?

MR. O'DONNELL: In the 21% case the Chief Commissioner said, if I can find the passage, that there is no mathematical exactitude as to what the rates shall be, and they have to use their best judgment. That is what they were established for. That is why they were put there in 1903, to remove from the government the obligation that prior to that year, as I remember it, was carried on by the railway committee of the Privy Council. This function was taken away from the government and turned over to the Board of Transport Commissioners, to men whom it was felt were able to handle this matter in a businesslike way. They were put in charge of things and they were told to make adjustments, to look into things and try to hit upon what was fair and reasonable. They were given the broadest possible powers to do that. They did not have to follow any formula or any set of rules as to how they would establish rates. They are given these very broad powers under section 325. The Chief Commissioner, when invited by the provinces to disregard the Canadian National completely, said this at page 36 of the 21% judgment:

"I cannot accept the contention of counsel for the respondents, that the requirements of Canadian National Railways should be entirely disregarded. The fact that Canadian National Railways are publicly owned is not a good reason for excusing the users of the railways from paying just and reasonable rates for services rendered. To do otherwise can only result in calling upon

the taxpayers to meet large deficits which is something which I think desirable to avoid as far as may be reasonable and practicable.

"Some regard must, I consider, be had to the needs of all the railways."

The proposed amendment introduced by my friend yesterday to section 325 names the C.P.R. and provides that its requirements are to be taken care of, but under the law and under cases which have been on the books for years all railways are entitled to live in Canada, and the Board has to fix rates.

THE CHAIRMAN: When you say "all railways" what in effect do you mean?

MR. O'DONNELL: I mean --

THE CHAIRMAN: In so far as any judgment is concerned, did the Board not have before it for consideration the position of your railway and the C.P.R.?

MR. O'DONNELL: And the eighteen or nineteen other applicants who were likewise associated in the application of the Railway Association. The Chief Commissioner said that inasmuch as the two major roads had the bulk of the business it was fair to suggest that rates should be fixed --

THE CHAIRMAN: Does the fact not remain that the Canadian Pacific is the only privately-owned railway?

MR. O'DONNELL: No.

THE CHAIRMAN: Are there others?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Can you name me some of them?

MR. O'DONNELL: It is in the application. I do not remember offhand.

MR. EVANS: The Toronto, Hamilton and Buffalo, the Napierville Junction, the Ontario Northland.

THE CHAIRMAN: I am not talking about provincial railways. I mean those subject to the jurisdiction of the Board.

MR. EVANS: There are the Algoma Central, the Napierville Junction, the New York Central coming into Ottawa, the Wabash which operates mostly over the line of my friend between Detroit and St. Thomas, I believe, the Chesapeake and Ohio. They all come under the jurisdiction of the Board.

MR. FRAWLEY: It may be of interest to note that the financial statements of all these railways were put in as exhibits in the 30% case, and there was a wide variety of need. It ranged all the way from the Toronto, Hamilton and Buffalo that did not need any increase at all down to the Temiscouata Railway where a 200 per cent increase in freight rates would not have aided it. That was the range we had, and the Board simply took the Canadian Pacific Railway.

MR. O'DONNELL: There are eighteen or nineteen roads which are listed in Schedule A to the application.

THE CHAIRMAN: Does each one of those eighteen or nineteen roads operate itself?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Manages and operates itself?

MR. O'DONNELL: I am not as familiar as I might be with this. The Central Vermont, the Michigan Central, the New York Central, the Pere Marquette, the Wabash all run into Canada, and they have an interest.

THE CHAIRMAN: What about wholly Canadian railways?

MR O'DONNELL: Well, the Toronto, Hamilton & Buffalo operates here; it has its own independent management. It has some wealthy friends who have an interest in it, but it is operated quite independently, as I understand it. Now, that is what the Chief Commissioner was talking about. He said, "However, there is no use going over the individual cases of the nineteen or twenty in the same detail that we will have to review"---

THE CHAIRMAN: Were all these railways members of the Association?

MR O'DONNELL: Yes, my lord, members or associate members.

THE CHAIRMAN: Which fixed upon the 30 per cent as being the reasonable increase to ask for.

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: I still would like to know what sort of yardstick you used in this Railway Association to arrive at that common need for all of you, 30 per cent.

MR O'DONNELL: Well, I do not know just what---

THE CHAIRMAN: That is, you must have been very much closer then than you appear to be now.

MR O'DONNELL: As far as my road is concerned, as I understand it, we simply looked at it this way: We said, in 1946, doing virtually as much business as we were doing in the peak war years, our position has been changed from the surplus position that we had to the deficit position by reason of these tremendous increases in prices of materials which are used by our railroad and in the wages which are paid to our employees.

THE CHAIRMAN: I am not talking of whether 30 per cent was too high or too low.

MR O'DONNELL: No, I am not either; I am just trying to tell your lordship---

THE CHAIRMAN: I am talking of this remarkable degree of unanimity.

MR O'DONNELL: Well, I imagine there was discussion. I would assume that the railroad that had the 200 per cent need of increase said, "Well, 30 per cent will not be enough for us," and the Toronto, Hamilton & Buffalo said, "Well, we don't need any," but there must have been a discussion and a mean amount arrived at that would, in so far as it is possible to have any exactitude, take care of the situation.

THE CHAIRMAN: Would the 30 per cent represent the necessities of the most needy of all these eighteen or twenty?

MR O'DONNELL: On the average I think it represented the necessities of the railroads that were to continue to do business in Canada.

COMMISSIONER INNIS: The C.P.R. was not the yardstick?

MR EVANS: Oh, yes, they were.

MR FRAWLEY: It is all in one paragraph that my friend started to read, my lord, on page 36. It is quite clear. My friend read the first line:

"Some regard must, I consider, be had to the needs of all the railways."

MR O'DONNELL: I was going to read the rest.

MR FRAWLEY: "But, as there can only be one rate for all railways, we should, I think, endeavour to arrive at a just and reasonable mean between the railways in fixing the rates. Upon consideration of all that has been placed before us I am of the view that this can best be accomplished by taking the requirements of the Canadian Pacific Railway Company as the guide or

measure, in the establishment of what we consider to be just and reasonable freight rates to be paid by the users of the railways."

That is the pith of what the Board said about yardstick.

MR O'DONNELL: And then the Assistant Chief Commissioner---

THE CHAIRMAN: That is the Board's yardstick, Mr. Frawley, but the question in ^{my} mind was as to the yardstick of the Railway Association of Canada.

MR EVANS: They did the same thing. They recognized that that was going to be the basis of the application, and it was made perfectly clear in particular in the 20% application that all railways agreed to accept what the Board might find was necessary for the Canadian Pacific.

MR O'DONNELL: Provided the formula which had been applied in the 21% Case were not disturbed, and we said that if it were disturbed---

THE CHAIRMAN: I beg your pardon?

MR O'DONNELL: Provided the formula in the 21% Case which the Board had fixed were not to be disturbed on the review, but the C.N.R. said, if that formula is to be disturbed, then our position will have to be looked at.

THE CHAIRMAN: When was that said?

MR O'DONNELL: During the 20% Case. We did not have to say it before that, because before that we put our figures and facts on the record in the 21% Case, and it was argued strenuously that we should not be taken into consideration at all. The Chief Commissioner said, "I can't do that, I won't do that." He said, at page 79:

"While my calculations have been based upon the figures and requirements of the Canadian Pacific Railway, I am not at all unmindful of the requirements of the Canadian National Railways.

These railways, so important to Canada, have now become well integrated and have a high standard in service and operating efficiency.

It is a responsibility not easily assumed to completely ignore them when fixing a rate increase. And I do not think that they should be."

Now, it was with that language in mind that we objected to section 325 being disturbed, because through the years the Board of Transport Commissioners, and the Railway Commissioners before them, have throughout adopted that policy, that the requirements of all the roads must be looked into, not merely one. Back in the early cases, as far back as 1914, your lordship will find there the statement that the requirements of all the roads have to be regarded, not merely the largest road or that which obtains the greatest carriage.

For instance, in the Eastern Rates Case, 22 C.R.C. 4 (7 J.O.R. & R. 145 and 147), in the judgment Sir Henry Drayton, who was then the Chief Commissioner, said, in part:

"The Grand Trunk Railway Company" --
which today is part of the Canadian National --

"was a line primarily built for the necessities of Eastern Canada. It runs into all the large producing centres; it has a well established and well worked up business; and in the territory where the vast majority of the rates in review are in question, does the largest business and obtains the greatest earnings.

There can be no question insofar as Eastern Canada is concerned, that any injustice could possibly be done the shipper in accepting for primary consideration the actual results of the Grand Trunk earnings as a basis of rates."

The Canadian Pacific were operating primarily and

chiefly in the west, and their position was felt in the west to be one that---

THE CHAIRMAN: That was in what year?

MR O'DONNELL: 1916, my lord.

THE CHAIRMAN: That was before your company existed.

MR O'DONNELL: That is right; but this integral part of our company today, the Grand Trunk, is what the Chief Commissioner was referring to.

Then in 1917, in the 15% Case, we have this statement again by Sir Henry Drayton, referring to the tariff situation and the railway subject, which is

" . . . surrounded with much difficulty, but some things are at least clear. Among them it is clearly the duty of the Board to allow fair and just rates to carriers for the service they perform."

Then he goes on to say:

"There is no reason why the business of the Canadian Northern should be conducted at a loss simply because the country owns it."

And further:

"Whether there be room for issue on this score or not, at any rate under the Railway Act the Board cannot consider rates on the Canadian Northern on a different basis to those on other roads simply because the country will in the future own the stock."

That is not exactly the one I was looking for, my lord.

In the 40% Case, in 1920, then Chief Commissioner Carvell made these very pointed remarks, speaking of just and reasonable rates and the fixing of just and reasonable rates:

" . . . this Board must approach it from the standpoint of the law as it now stands, which imposes upon this

Board the duty of 'fixing, determining and enforcing just and reasonable rates' not only for the Canadian Pacific Railway but for all other railways under its jurisdiction."

COMMISSIONER ANGUS: Mr. O'Donnell, is that quite consistent with your saying you are not asking to be made a yardstick? Aren't you really saying that you are in fact recognized by the Board as a component in the yardstick or as part of the yardstick or something of that sort?

MR O'DONNELL: Well, we are saying simply that the Board cannot completely ignore this very important part of the railway system when fixing rates; that is true.

COMMISSIONER ANGUS: Those are very vague phrases, "cannot completely ignore", "cannot overlook", and so on. What account do you think the Board should take of the needs of the Canadian National Railway? What is the measure of those needs?

MR O'DONNELL: The measure of those needs is the measure of what would be just and reasonable to all who have any interest in the operation of railroads -- the carriers, the shippers, the people.

COMMISSIONER ANGUS: What would be the measure of what is just and reasonable?

MR O'DONNELL: That is something that the Board must use its best business judgment about, in my respectful submission, and that is what under section 325 they are permitted to do today.

THE CHAIRMAN: Is that answered by the formule of requirements?

MR O'DONNELL: Well, it is -- as I said yesterday, my lord, the Board does not have to fix rates on the basis of requirements. It has heretofore done so, but it does not have to. It can adopt the other way -- that is, on the rate

of return basis, or any other manner of fixing rates; and, in our view, that is the way the law should be allowed to remain, completely unfettered.

THE CHAIRMAN: All that you are telling us now is directed to this argument, that section 325 should not be altered in any way; is that right?

MR O'DONNELL: That is correct.

THE CHAIRMAN: It should be allowed to remain as it is.

MR O'DONNELL: We think so.

THE CHAIRMAN: And that even if the recapitalization of your railway is done, that would furnish no reason for any safeguard to be introduced into section 325 to protect other railways.

MR O'DONNELL: We are satisfied that the Board of Transport Commissioners will see to it that what is right and fair shall be done.

THE CHAIRMAN: You do not think that it is possible that you may be put in a position to earn such surplus as would be a menace to the other railways?

MR O'DONNELL: No, we do not; and on the evidence before the Commission as it is to date, that is our view.

THE CHAIRMAN: Then you think that the fears of the Canadian Pacific in that respect are perfectly groundless?

MR O'DONNELL: That is our view. We think there is no reason for keeping us in the poorhouse at this point. We are simply trying to get an adjustment which, on the best judgment of those who have come before your lordship -- and they are the senior executive officers of the railroad, the President, the two Vice-Presidents, who have considered the problem, and the two Vice-Presidents have been with the problem for years and years -- this proposal which they make

would not harm the other road at all, and we submit that their fears in the circumstances are quite groundless. If we had a \$13 million surplus after the adjustment, surely that is nothing to be disturbed about, because if we have \$13 million our friends will have more than that, much more. That is our view. I am sorry to have taken so much time.

COMMISSIONER ANGUS: Mr. O'Donnell, you say, "Rates should be just and reasonable to the Canadian National, and what is just and reasonable is what the Board may say is just and reasonable, because we have great confidence in it."

MR O'DONNELL: We have confidence in the Board, yes.

COMMISSIONER ANGUS: Why do you ever address an argument to it, if it is omniscient?

MR O'DONNELL: Well, we have addressed arguments to it, on the basis that we know the Board has the power to fix the rates, and we assume that they are going to do it in the light of the evidence placed before them and of what the needs and requirements are from time to time. They have a continuing duty, and they vary the rates up or down as the occasion requires, in order that the railways of Canada be kept healthy as a whole. That is our frank attitude with respect to the Board of Transport Commissioners. On occasions their assessment of the matter may be placed at a lower figure than we would like, in which instance we are entitled to go back and ask them to review it, and they can review it under section 51; they can at four o'clock change an order that they made at eleven o'clock, as far as that is concerned, and that has been the way they have operated through the years, and successfully operated, in my respectful view. There has been a lag in

the last few years; I agree with my friend Mr. Evans in that. The relief which should have been granted was not concurrent with the expenditures which were forced upon the roads by these wage increases. It took too long a time to get an adjustment, but that is something which is a temporary matter, and the arguments which were addressed to the Board, and which took such a long time to dispose of on the various contentious points, have been more or less settled, we hope, and our hope is that in the future it will not take so much time to settle these matters. The 20% Case in January of this year took four days, I think; the review of the hearing on that judgment, which gave the railways 4 per cent less than they had applied for, took one day this time.

Now, there was a cycle, or there is a cycle, in these things. There had been no rate increases since 1922, I think it was, and then in 1948 an application was made. Well, a lot of things had happened since 1922, and there were a lot of arguments addressed to the Board that took a lot of time, but we would think that in the future they can handle their business much more expeditiously than that, and we have confidence that they will, and that is why we say that 325, as it has stood the test of time, should be allowed to remain there, and we say that with our amendment we will not have any enormous surpluses such as our friends fear, and if we did we say our shareholders would put the same pressure on us as the shareholders of the C.P.R. put upon them to declare a dividend or pay it over.

I am sorry I have interrupted to take so much time.

COMMISSIONER INNIS: There seems to be a general recognition that the C.P.R. is not acceptable as a yardstick, or that the Canadian National is not acceptable as a yardstick. Is there any possibility of developing, through the machinery

which is established, for example, in the Association, some sort of formula which is acceptable to the various groups? -- and I presume that there would need to be included consideration of the position of labour as well as the position of the provinces.

MR EVANS: Well, I think the answer, Dr. Innis, to that is that the provinces, whatever may have been their basis for opposition, have consistently agreed that the Canadian Pacific was the proper yardstick. I do not think there has been any question of that on the part of the provinces. What they have tried to do has been to cut down the needs of the Canadian Pacific, and even in some cases to suggest that there were no such needs, but they never at any time have taken the position that the proper yardstick was not there. It is the measure of what was reasonable that has caused the dispute.

COMMISSIONER INNIS: The Board seems to have drifted pretty appreciably from that position, and I think that arguments might easily be made to the effect that you cannot tie down the economy of the country or of one railroad or of another railroad to the yardstick which was imposed by another railroad.

MR EVANS: Well, as a matter of fact, in the United States the position, I would suggest to you, is even less satisfactory, because there the return on investment is calculated by reference to a group in certain territories, rate territories, the eastern and the western and the southern, and they lump all the railways together. Now, in doing that, and to try to give each of them a fair return, you are bound to get some who will get no return and others who will get a very large return; but in Canada---

THE CHAIRMAN: Pardon me. Is there any provision for compensation there?

MR EVANS: Compensation? Only so far as the railways operating under the rate structure as found by the Interstate Commerce Commission can operate at a profit.

THE CHAIRMAN: How about those who cannot operate at a profit, the poor railways? How do they get along on a structure that is built over their heads?

MR EVANS: The answer to your lordship is that a lot of them have not got along; a very great number of them have gone through bankruptcy proceedings. They have had their capitalization written down, and they have had a very drastic change in their requirements. But, as I was going on to say here, the position in Canada is a little peculiar. We have two large transcontinental systems; that, to begin with, is the one thing that is lacking in the United States. The second thing is that the other railways are minor in mileage; they are very small local railways. The third thing, and the most important thing, is that we have a publicly-owned transcontinental system competing with a privately-owned one. Now, that in itself produces a very different kind of problem, and I for one have no objection, as Mr. Walker said, to the Canadian National becoming part of a joint yardstick with us if some basis can be found under which the return on their investment or a reasonable level of investment can be put alongside ours.

THE CHAIRMAN: Do you think any such basis might be found?

MR EVANS: Well, I am hoping so. I have been trying to develop here what the views of the Canadian National themselves are, as to what they think would be proper for them to earn. I am trying to get the views of the Canadian National as to what they themselves think should be the proper earning.

Now I must turn, I think, to : correct what I think is an inadvertent mistake by Mr. O'Donnell in his statement to you, that Mr. Cooper's Exhibit 246 showed that in 1949, with all the rate adjustments asked for, the Canadian National would have a surplus of \$13 million. Actually the Canadian National exhibit showing such a surplus was based on an increase of 16 per cent being in effect for the full year. Now, we have applied for 20 per cent, both of us have; both of us have felt that 20 per cent is the minimum needed, and so I am going to suggest---

THE CHAIRMAN: Have any of these smaller railways joined in this further application?

MR O'DONNELL: Oh, yes, they are all in.

MR EVANS: Yes, they are all in. But what I wanted to say to your lordship was this, that I can show, and part of my cross-examination of Mr. Cooper was designed to show, that 20 per cent on the Board's formula, and forgetting all the allowances of expenses that are involved in that formula, 20 per cent on the Board's formula would produce for the Canadian Pacific in 1949 a surplus of only \$14 million, a million short of the surplus the Board said was proper. That is the first point.

(Page 20330 follows)

I say that on a comparable basis - and I am quite prepared to prove these figures - the Canadian National with a 20% increase in rates in 1949 would have had a surplus of More than \$28 million or about double ours. That meets my friend's point when he says a dollar of surplus to the Canadian National means more than a dollar of surplus to the Canadian Pacific.

MR. O'DONNELL: We will have to let Mr. Fairweather deal with that. I would say that Exhibit 240, shows a surplus of \$13,698,000, and if there were to be added to that the additional \$7 million that would result from the additional 4% increase, it would still only come up to \$20 million; and when we got \$7 million, our friends would have had \$7 million. In the circumstances, taking into consideration that we do about a third more work than they do, have a third more mileage, have more locomotives and box cars, it is not at all unreasonable that there should be a slight discrepancy and with that being proven we might have a little more return than they have. That is not at all unreasonable.

THE CHAIRMAN: Shall we be getting back to Mr. Fairweather?

MR. EVANS: Yes. It is hard to know where to begin with Mr. Fairweather.

MR. S. W. FAIRWEATHER - RECALLED

CROSS-EXAMINED BY MR. EVANS:-(Cont.)

Q. I think when we finished last evening, we had been talking about what the Canadian National had in mind with regard to the disposition of its surplus, and we have heard I think from Mr. O'Donnell a suggestion

that you have not foreclosed the idea of paying some part of your surplus to the equity shareholder, the Government. Have you given any thought, first, as to what you think the surplus ought to be if the balance of rates and costs was redressed and second, how you would evaluate the need for paying some part of that surplus to the Government?

A. My only answer to that would be this. Our submission for recapitalization of the Canadian National Railways had a very modest objective. That objective was, as I stated rather graphically before, to take us out of the poor-house; because by so doing, it was the judgment of our management that they could improve the managerial efficiency of the property. These other hypothetical and suppositional ideas as to what might happen when we get out of the poor-house I consider as largely irrelevant. From my dealings with the Canadian National Railways, and if my judgment as an analyst is of any value, I know that the recapitalization such is here contemplated, would not on the average produce large surpluses. If it produced on the average a little more than the zero figure that has been mentioned, I would not be surprised. But that it could produce large amounts beyond that, having regard to the trends that I have stated, and having regard to demands for additional capital which will have to be met, is contrary to my opinion; if it does, then I am a poor analyst.

COMMISSIONER ANGUS: If the Canadian Pacific were given the level of rates which it was suggested were appropriate, you would then have large surpluses,

would you not?

A. No. That is, if I understood your question to mean a level of rates such as would keep the Canadian Pacific in a healthy condition.

Q. If they were given a level of rates which enabled them to earn the rate of return that they have suggested is appropriate, on the rate base that they have suggested is appropriate, you would then have a large surplus, would you not?

A. No.

Q. Why not?

A. To explain that we would have to go back to my remarks rpreviously about traffic density. The two properties are not identical. The great outstanding difference between them is in their traffic density . As I said, the operating ratio varies in proportion to the inverse square of the traffic density. Consequently when traffic density drops, the operating ratio goes up at a very sharp rate. There is approximately a ten per cent difference between the traffic density of the Canadian National and that of the Canadian Pacific Railway, the Canadian National being about ten per cent less dense than the Canadian Pacific. That has the inevitable effect that the Canadian Pacific has a cushion of net revenues which the Canadian National does not have. I expressed it previously by pointing out how barometrical the net earnings of the Canadian National were. I think perhaps I might illustrate what I have in mind if I submit a little statement which I prepared, showing the amount of money available for fixed charges which I as an economist consider to be the primary test

of stability.

Q. That amount would be increased by higher rates, would it not, if there was an increase in the base?

A. Yes. But what my point is, is this. There is a relativity. Might I suggest that this little statement be perhaps put in the record.

MR. O'DONNELL: He means marked as an Exhibit, my lord.

MR. COVERT: It will be Exhibit 271.

<u>EXHIBIT 271</u> ... filed by	:	Statement of Revenues
Mr. O'Donnell	:	Available for Payment
	:	of Fixed Charges -
	:	C.N.R. and C.P.R.
	:	1923 - 1948.

THE WITNESS: In this statement, I have shown the net revenues available for payment of fixed charges of the Canadian National Railways and the Canadian Pacific Railway over the years from 1923 to 1948 inclusive, and I have shown the difference. You will see that for all years except the years 1942 to 1945 inclusive, the difference was in favour of the Canadian Pacific Railway, and is a measure of that cushion which I said exists. Those war years where the situation is reversed are very exceptional and cannot, in my opinion, be of any value whatever in forecasting the future. A war economy is quite different from a peace-time economy. Actually these amounts shown in the war-time are not true earnings at all. They are simply part and parcel of the burden of bearing the terrible destruction of the war. They are like a shot of adrenalin put into an animal; he will behave for a short time in a certain very vigorous manner. But even had you continued the state of war you would not have continued these earnings. You could

not have continued those earnings. They are, in fact, not earnings as such, in my opinion, at all. So if you look at peace-time operations, you will see how quickly, after the war-time stimulus disappeared and the artificial conditions of war disappeared, the trend re-asserted itself. You will find too, that that trend re-asserted itself because we came back once more to the position of traffic density that had existed prior to the war. That relativity will continue, so far as I can see, so that as the industry of the country increases, and as we get more population, there will be a continuing tendency for the Canadian National Railways to remain inferior in traffic density to the Canadian Pacific. Consequently, and for that reason, rates which yield a certain return to the Canadian Pacific Railway will yield to the Canadian National a return available for fixed charges, in my opinion, somewhere between \$20 million and \$30 million a year less. If you look at that analysis of our fixed charges, you find this condition. The Canadian National Railways has asked for an adjustment of its fixed charges which will reduce them in 1949, if you give credit for the \$9 million interest on the special funds which Mr. Gordon recommended, a figure of \$17,833,613. If you look at the fixed charges in the return from the Canadian Pacific Railway for 1949, you find them stated at \$14,543,817. I therefore submit that the Canadian National Railways will, on the average, have \$20 million to \$30 million less available to pay fixed charges which are greater than those of the Canadian Pacific. That is why I say that these fears of the Canadian Pacific with regard to this modest statement of recapitalization of the Canadian National and that

this apprehension that it will have some terrible effect on the Canadian Pacific is something that I cannot see.

COMMISSIONER ANGUS: Q. I must have asked my question very badly. My question in its simplest form, I suppose, is this. Would rates which increased the net income before fixed charges of the Canadian Pacific Railway also increase the net income before fixed charges of the Canadian National Railways?

A. Yes, it would.

Q. In that sense, would that produce a surplus of some size?

A. It would produce a surplus of some size. But what I said was that, over the years, that surplus would not be substantial in amount. I would not say that it would average zero, but it certainly could not average any large amount, in my opinion, knowing what I know of the Canadian National Railways.

MR. EVANS: Q. As to Exhibit 271, Mr. Fairweather, I have not had a chance to study it. But do the figures shown in the C.P.R. column include this Other Income or just rail income?

A. These figures are taken from the Dominion Bureau of Statistics' analysis of the Canadian National Railways and the Canadian Pacific Railway.

Q. I am not doubting the accuracy of the figures, I merely wanted to know what was in them.

A. The figures are on that authority. The authorities are Exhibit 232, the C.P.R. and Exhibit 218, C.N.R., which are the Dominion Bureau of Statistics' analyses of the Canadian National and the Canadian Pacific.

Q. You do not know whether the figures include Other Income, whether it is corporate income?

A. I know the analysis was made for the purpose of making them comparable.

Q. My information is that they include the Other Income.

A. I will be glad to check that feature.

Q. Yes.

A. It starts off with this: Operating revenues, operating expenses, net operating revenue, net income before fixed charges.

Q. Yes.

A. And there is a note "D" on that.

Q. At all events, my instructions are that those figures of the Canadian Pacific do include Other Income; and I think you would agree that on that basis, assuming that they do, it would hardly be fair to compare the results, for our purposes, based on the other income earnings of the Canadian Pacific Railway.

MR. O'DONNELL: When you say "Other Income", what do you mean?

MR. EVANS: Other than railway income. I thought we had arrived at a common term.

MR. O'DONNELL: I did not know what my friend meant. I understood him to say the figures include "Other Income". They include certain railway income.

MR. EVANS: All I put to the witness was that my instructions were that these figures did include Other Income of the Canadian Pacific Railway; and I asked him whether, if that were so, it would not be unfair to make such a comparison.

Q. Perhaps you would like to take time on that.

A. Yes; I think I should on that.

Q. We can come back to that matter again.

A. Yes; we can come back to it.

Q. Before we got into the last discussion, I think I

had asked you a question. Perhaps I should more fairly have put it to you in two parts. Have you given any consideration, as ^{an} officer of the Canadian National, or has the Canadian National itself given any consideration as to how much surplus they should be permitted to earn under the rate structure?

A. I have already stated that our objective was a simple one. It was to give us a chance of operating without chronic deficits.

Q. Is your answer to my question that you have not given consideration to the extent of your surplus, or what it should be?

A. I think that would be an inference. We are content if we can operate without deficits.

Q. Yes.

A. If I might add to that answer, I should like to add this. It is my considered opinion that if we are desiring to put the capital structure of the Canadian National on a basis where it would be completely self-supporting, the reduction in the capital structure would have to be more drastic than it has been suggested it should be. I have no reservations on that score. That is why I said that our reduction which we were requesting is considered as modest.

Q. May I put this further question to you. As an officer of the Canadian National, are you prepared to say that at no time in the future will the Canadian National ever earn as much as \$50 million surplus after fixed charges?

A. Oh, I would not say that would be an utter impossibility. In a property of the size of the Canadian National, and under very special conditions, I would not think that that would be an absolute impossibility; but what I say is this. If the Canadian National ^{was} / earning such a figure, the Canadian Pacific would be earning a bigger figure. That is what I am saying.

Q. That is your view?

A. Incidentally, it just comes to my mind that while I used in that previous submission the amount available for fixed charges you will find almost the same, or substantially the same difference, if you just stick to net revenue from railway operations, so that my point is fully substantiated.

Q. Of course we have got to go into that a little, but since it might happen that the Canadian National would receive a surplus of \$50 million, and leaving aside for the moment what kind of surplus the C.P.R. would have, what in your view would be the means by which that surplus would be disposed of? Would your view be you should keep it all or pay a part of it, or what part of it, to the government?

A. I think that would be a matter first in the discretion of the board of directors of the Canadian National, and secondly a matter of concern to the shareholder. You can hardly expect me to say what might happen in some hypothetical situation that I cannot see as probable although I say it is conceivable. I think it would be a conceivable idea that if such a surplus did exist it would be a reasonable matter for consideration of the board of directors of the Canadian National Railways to turn over some of it to the government, and if they did not elect to do so I consider it conceivable that the shareholder would say to them, "Now, we are not satisfied with the way you are dealing with this thing and we will have something to say about it in our annual meeting."

Q. Now then, if such a surplus did eventuate, and there was pressure brought upon the government and upon the Canadian National to give back some of that surplus,

as it were, or to reduce rates so as to eliminate such a surplus in the future, would there not be a real danger that that pressure would become so great that you would have to consent to a reduction in rates?

A. Well, I think you are looking at this thing unilaterally, and I cannot look at it unilaterally. This surplus you are talking about to the Canadian National would be accompanied by a larger surplus to the Canadian Pacific --

Q. Does it not --

A. May I continue my answer?

Q. All right.

A. Under such circumstances the question of adjustment of rates may arise. I cannot say, but I cannot see how it would arise out of a surplus of Canadian National which, owing to the capital structure as adjusted, would be always smaller than that of the Canadian Pacific, that is, the amount available from the operations of the railway.

Q. Now, I take it your whole answer depends upon the assumption that the surplus under given conditions which the Canadian Pacific would get would at all times be greater on a given level of rates than that of the Canadian National?

A. Let us get this straight. What constitutes a surplus is perhaps a little debatable. What I would prefer to talk about is the amount available for fixed charges. That is the test of stability, as I see it.

Q. I will take it either way.

A. I will take it as available for fixed charges, and then I say on that ground that I am perfectly certain that in normal operation of the railway business in this country that the Canadian Pacific will have a greater

amount available before fixed charges than the Canadian National by reason of the difference in traffic density of the two properties, always assuming of course that the Canadian Pacific continues to have the same high degree of efficiency it has had in the past.

Q. Oh, quite, and I would not ask you to assume otherwise. Taking the position in which we now find ourselves where the Canadian National traffic density is about 10 per cent less than the Canadian Pacific, let us assume that it develops in the future that the traffic density of the Canadian National is 10 per cent more than the traffic density of the Canadian Pacific. Would you then assert that the assumption upon which you made your last answer would obtain?

A. Oh, certainly not. If we should by some conceivable condition overcome that handicap of traffic density I should expect that the Canadian National operating results would reflect it. I maintain that we are an efficiently operated property, and that would necessarily flow, but I would add that from my size-up of the conditions in Canada, as I have been studying them for years and years, it does not indicate any probability of that happening. As a matter of fact, as I have stated I see a job of work coming along to the Canadian National Railways in the future of adding to the development of this country by extending lines, and that will dilute our traffic density, so that we will be tending to increase it in one direction by the growth of the country and we will be tending to dilute it as we have to have development lines.

COMMISSIONER INNIS: Mr. Evans, I should like to push your argument a little bit further.

Q. Let us assume that you have secured a surplus,

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both in the case of the Canadian National and the Canadian Pacific, and let us assume that the next step follows, that is to say, the provinces insist on having lower rates and labour insists on having more wages, and as a result the trend starts downward. In a downward trend do you think that your position would be better than in the case of the Canadian Pacific, or would the Canadian Pacific be in a better position?

A. Always the line with the lower traffic density suffers, and if we were faced with a reduction in revenues it would shove our operating ratio up at a faster rate than that of the Canadian Pacific in the same circumstances.

Q. It would not shove it down?

A. It would shove the operating ratio up.

Q. Oh, the operating ratio.

A. Yes, and the net available for fixed charges would go down.

Q. Would the Canadian National not be in perhaps a little more exposed position with regard to demands for rate reductions or demands for increases in wages, and consequently would that not press on the C.P.R. a little bit more than ordinarily would be the case?

A. That is a very interesting question. It is a matter on which I do not mind saying that in my early association with a government-owned enterprise I had substantial fear. Experience gained over some thirty odd years, a little more than thirty years, has taught me that if we can continue in the future the same sort of managerial skills and the same type of direction that we have had in the past, that those fears are groundless. The privately owned property and the publicly owned property have met on those matters and

have seen eye to eye, and have dealt with them fairly and squarely, and I have not seen any discernible trend whereby the Canadian National management was softer than your private management in this regard.

Q. Do you think the attitude of the provinces or the attitude of labour is softer?

A. Well, the attitude of labour is naturally to get what it can, and I do not blame them. I can quite understand that the attitude of the public who pay the freight rates is that they desire to get them as low as they can. It is always a stress between opposing forces. All I can say is that in my experience the management of the publicly owned railway has not been deficient in that regard.

MR. EVANS: Q. Now, Mr. Fairweather, speaking of this possibility that the traffic density of the Canadian National might equal or exceed at some future time the traffic density of the Canadian Pacific, are you quite clear in your mind that there is no such possibility?

A. I think it would be very remote. I cannot conceive of it, but I am willing to assume it as a hypothetical question.

Q. Because I was going to put to you a statement made by Mr. Hungerford in 1938. This statement comes from the proceedings of the special Senate committee in 1938. At page 1055 he said:

"The Canadian National has far greater potentialities than its principal rival in Canada, or for that matter any other railway on the continent, because no other railway is so well located in relation to the natural resources of the northern half of this continent. Consider, too, that in the highly industrialized section

of the country, which will continue to draw its stimulus from the development of the north, that the Canadian National is pre-eminent in serving every industrial centre, and I think you will realize the truth of what I have said, that the potentialities of the system are very great."

Would you agree with that?

A. Oh, I agree with it, but a great many people did not. I seem to recall times when words like that were considered to be utter folly. I agree with them. I think the Canadian National has potentialities, and I have tried to explain that these potentialities are substantial in themselves, that it is reasonable to suppose that there will be growth, and that there are discernible trends also that make that problem, let us say, less clearly definable as to the future.

Then again, while our northland is a vast storehouse of wealth, the tapping of that storehouse of wealth is going to call for large amounts of additional capital. There is no doubt about that.

Q. Would that not be likely to be, at least in part, also the duty of the Canadian Pacific to build development lines and to undergo the stresses?

A. Yes, and to the extent that they did they would participate in the same advantages.

Q. We were speaking there, and I think you agreed with this statement, that the Canadian National had far greater potentialities than the Canadian Pacific?

A. I agree with it, yes, that in my opinion it has greater potentialities, and also accompanied by greater problems. I think that is what Mr. Hungerford was aiming at. He was trying to explain a situation where the Canadian National was being charged at that

time with being such a burden on Canada that it was bankrupting the country, and he was explaining that if you had patience and let the country grow up to the size of the Canadian National that it would change the picture, but where I qualify it is that in that growth the Canadian Pacific would also be growing. Mr. Hungerford did not say the Canadian Pacific would not grow in importance also, and what I am saying is that the relative position of the two properties would not in discernible time change to a point where the traffic density of the Canadian National would equal or exceed that of the Canadian Pacific, and traffic density is the basic factor in determining the availability of funds under the same rate base.

Q. May I suggest this to you, and I wish you would check me if I am wrong about it, that since 1917 the traffic density per mile of line measured in net ton miles of the constituent lines of the Canadian National has increased by about 90 per cent?

A. Since what year?

Q. From 1917 to 1949.

A. Yes, I would not be surprised at that.

Q. I suggest to you in the same period the Canadian Pacific growth in traffic density expressed in the same terms is about 37 per cent?

A. Yes, but what was the difference in traffic densities of the two properties?

THE CHAIRMAN: Will you please repeat the figure for the Canadian National?

MR. EVANS: I suggested to the witness, and he agreed, that it was probable that the traffic density, expressed in terms of net ton miles, had grown by 90 per cent since 1917.

THE CHAIRMAN: In the case of the Canadian National?

MR. EVANS: Yes, in the case of the constituent lines of the Canadian National. I also suggested to him that in the same period the traffic density of the Canadian Pacific in the same terms of net ton miles had grown by approximately 37 per cent.

THE CHAIRMAN: The Canadian Pacific.

MR. EVANS: The Canadian Pacific.

Q. Have you any reason to doubt that?

A. I have no reason to doubt the accuracy of the figures, but I still say that it does not vitiate in the slightest degree my general conclusion. I do not know quite what it would mean. If you are leading from that to the inference that at some time in the reasonably foreseeable future we would overtake the traffic density of the Canadian Pacific I would differ because, for instance within a discernible time, we have added to our system within the last year somewhere around 800 miles of railway with a traffic density so low that you cannot discern it.

Q. I would be the last to suggest, Mr. Fairweather, that you should not perhaps have the Newfoundland Railway on terms that would eliminate that from any calculation as compared with the Canadian Pacific. I am not asking that we leave you in a position of holding back on the Newfoundland Railway. I am not asking that at all.

A. I only used that as an example, but if you start lopping off from the Canadian National all of these things that I point to as being conducive to low traffic density and take a look at the remainder of the property, you would eventually come to a place where the traffic density of the remaining lines would be higher than that

of the Canadian Pacific, and I say that is unrealistic. I pointed out the other day to bring the traffic density of the Canadian National up to the traffic density of the Canadian Pacific -- and I think the calculation was made before the inclusion of the Newfoundland Railway -- would require some 2,383 miles to be lopped off the Canadian National system. If you did that sort of thing I would be prepared to agree with you.

Q. You are not prepared to countenance the possibility that the Newfoundland Railway might be left out of the system accounts and treated separately as in the case of the Hudson's Bay Railway?

A. I think evidence was given with regard to that. We stated our case to the government, and the government, for reasons that they thought good and sufficient, said, "We entrust it to you to be included in the Canadian National System." I know that it is not an open and shut case. I think for the Canadian National Railways to try to achieve a favourable income position by taking sections of the country to which it extends service and reducing them, so to speak, to second-class communities is a matter that requires serious consideration.

(Page 20352 follows)

They are entitled to Canadian National service and they get it. To segregate them and to say to them: "You are a sort of dead losing proposition and we cannot treat you as anything except a second-hand cousin," has a distinct bearing upon this problem.

THE CHAIRMAN: Q. Are you describing, for instance, the position of the Hudson's Bay Railway?

A. No. I look on that, sir, as it was, ^{as} a purely experimental line for a specific purpose to reach a port on Hudson Bay; and there were, perhaps, good reasons for excluding it.

Certainly there was not, in that area, any of these elements of public convenience and necessity that I am talking about. Any traffic moving over it was moving to an experimental port.

But what I refer to is a thing like the Temiscouata Railway. There you have an example of a road taken over by the public for reasons which were thought to be good and sufficient, and entrusted to the Canadian National Railways.

I personally think it would be difficult to segregate it out and to say that everything done on the Temiscouata Railway shall be kept in one little packet and be dealt with that way. I say that it introduces bad managerial possibilities, and it certainly introduces a bad attitude towards the public.

I think the way in which Mr. Gordon has submitted this thing is much more sensible. We take them in and we discharge our stewardship and we say: "Give us relief."

---Recess.

---Upon resumption.

THE CHAIRMAN: Very well, Mr. Evans.

MR. EVANS: Q. I want to put one or two further suggestions to you, Mr. Fairweather, in the terms in which they were put by Mr. Hungerford in the same proceedings.

Mr. Hungerford at page 1048 of these same proceedings spoke of the average of \$45 million earned by the Canadian National after payment of operating expenses in each of the five years 1925 to 1929; and he said that was despite the fact that a program of rehabilitation of properties was going on involving very heavy operating charges. And he said that "under similar traffic conditions in the future I am confident that the net earnings would be substantially greater." Would you agree with that?

A. I would certainly agree with it if the future had not contained qualifying developments.

Q. You are thinking mainly, I take it, in terms of motor competition.

A. I am thinking in terms of motor competition and also in terms of inflation of the dollar, which necessarily bears heavily upon low traffic density lines.

I think there is inflation and there is motor competition and increased water competition as well as increased air competition and the necessity for developing all lines; and finally something which I think has a distinct bearing on the future.

Mr. Hungerford was speaking of the things that had to be done to bring the property into good operating condition in that period up to 1929.

Subsequent to then we had a great depression

and in that great depression we adjusted our program of what constituted good physical conditions, fair and reasonable physical conditions of the property to be in accord with the traffic level that seemed then to be in evidence.

In doing so we created a managerial problem. And when the tremendous surge of traffic of the war, and the continued high level of traffic of the post-war period took place -- I know that what I am referring to is perhaps a bit technical, but it is a real managerial problem.

It is nothing short of a marvel that the Canadian National Railways were able to bear the burden of war traffic with a property that had been adjusted to a level of traffic of less than half of that amount.

It has left its mark on the property, and the results of operations in the future are going to be influenced by it.

With this qualification I agree with Mr. Hungerford's statement.

Q. Yes. The technical aspects of which you last spoke, and the effect of the depression on the plant -- I suppose all that was also something from which the Canadian Pacific had to adjust itself?

A. I really would not know what the Canadian Pacific did, or how much they did, or to what extent they followed the same policy as the Canadian National. I speak for the Canadian National policy and I speak of it with knowledge.

Q. But it would not surprise you if that were so?

A. No, it would not surprise me. It is probably common to both properties, but I think it is perhaps a little harder on the Canadian National because the

Canadian National had not succeeded in 1929 in getting its properties into class A condition.

We still had thousands of miles of line that we were quite unhappy about; and of course, when the great depression hit us, we just had to shut down all plans for improving those lines.

Therefore in the period we are now looking at we still have that problem, and we still have the problem of picking up the stresses and strains of the war period.

Q. Now, with regard to the Canadian Pacific, of course the Canadian Pacific had a financial problem in the depression period which prevented it, as you know, from getting the necessary money for its capital improvements?

A. Yes, I am aware of that; and to some extent of how it was met and all that. But I think my statement remains a fair statement of the position, at least, of the Canadian National.

Q. Now then, you do recall that this statement made by Mr. Hungerford was made in 1938?

A. Oh, yes.

Q. And by that time motor competition had become quite a serious factor?

A. It was, yes.

Q. Because as I understood it, it had its greatest growth and probably its greatest effect on railway rates in the period of the depression and the years prior to the war?

A. I think that is a fair statement, yes.

Q. Now then, as regards --

A. Well, may I qualify my answer?

Q. Yes.

A. Up to that time, yes, I agree; but I think I

should qualify it with regard to the present prospective outlook.

Q. I thought what you indicated in your previous evidence was that you foresaw in the future and in the immediate present, increased highway competition?

A. Yes.

Q. I was not trying to take you away from that.

A. No, that is what I wanted.

Q. I think we agree with you that there was that tendency.

A. Yes.

Q. But I would suggest to you that there had been a very phenomenal and sudden growth in highway competition by 1938?

A. Oh, yes.

Q. And that in an extremely low traffic volume period the inroads upon the railways of highway competition were really very serious by 1938?

A. I would agree with you.

Q. Yes. Now, with regard to the matter of inflation -- I do not want to go into the details of it -- but there are two matters which I thought I would speak to you about.

In the first place, the table which you put in assumed the same level of non-variable costs per mile of line, notwithstanding the difference in traffic density?

A. That is right.

Q. Now then, I am^{not} trying to get down to detailed figures, but would this be a fair statement to make: that any material difference in traffic density which results from a tendency to a lower standard of maintenance of lines and services would reflect itself in

these non-variable costs?

A. Oh, I would agree that there is something like a quantum theory applicable to this business of fixed expenses; but I do not think that quantum theory would operate in this hypothetical case.

I set the variation in traffic density within the limits of what I thought was applicable to the quantum of fixed expenses. I know that the principle that is outlined in the statement is sound. It is perfectly obvious and it has been proven to be so by an analysis of operating ratios of railways with different traffic density.

Q. I was not going to challenge your general results. I am rather suggesting to you that if the difference in traffic density was a material one, you would expect to find a different standard of maintenance and operation in the case of lower density lines which would reflect itself in the non-variable cost?

A. It would, and it would come up by steps. There is no denying that. But I do not think it would apply to the case I have in mind.

Q. Notwithstanding the fact that a great many of your lines -- I think you said -- still have 56-pound rails, for example?

A. Yes. But that does not decrease expenses. It increases them.

Q. You say that with low density a 56-pound rail decreases them?

A. Certainly any engineer would say that a 56-pound rail with anything like modern wheel concentration that you have to handle -- not the locomotive but the trailing load of cars -- that a 56-pound rail is too light and you pay through the nose as long as you

leave that 56-pound rail in track, and that you tend to pay through the nose for track maintenance because your track gets out of line, your ballast gets pounded; your ties get cut, and it is not a desirable situation at all.

Q. You spoke of wheel concentration. I assume that involves a concentration of traffic density?

A. No, not from an engineering point of view. That damage is done by heavy axle concentration. It is a technical matter. It is just like a bridge. The rail is a bridge between the cars. The ties act as a bridge between the ballast. And the ballast acts as a bridge between the sub-grades; and you have to have quite a concentration down to the basic subject before it is distributed.

The 56-pound rail is good enough with axle concentrations in the neighbourhood of 20,000 pounds. But with axle concentrations up around what they have now with modern traffic, up around 50,000 pounds, it is not good enough.

Q. Is it correct to say that the frequency of movement of these axle concentrations really has no bearing on whether it is more economical or not to have a 56-pound rail?

A. I did not say that. If you only have one movement a year, then naturally you could afford to pay for the damage to your track, and so I would be better off. But if you have traffic density which takes place with even so much as one train mile per mile per day, on the average, I do not think that the 56-pound rail is suitable under modern conditions.

Q. That would rather suggest that economy would

require that all rail and track be kept to a maximum standard?

A. No, no. There is an intermediate position, and that is where your traffic density becomes a factor.

In our main line where we have a high frequency of service and very high axle concentration, we use a rail weighing as much as 130 pounds to the yard; and we use rock ballast as well.

But as your traffic density diminishes, you can deteriorate your track structure, I admit. But all I say is that in my judgment the 56-pound rail is obsolete. That is all I am saying. But we, unfortunately, have a lot of it in our track.

Q. You suggest that in the circumstances in which you find the 56-pound rail, traffic density is the lowest, and that it is more expensive to maintain that kind of rail than it would the heavier rail?

A. Yes, and that means we have to spend capital to do it. That is one of the reasons why I say that the Canadian National outlook is not, under this capital revision, by any means a feather bed.

Q. To go now to motor competition for a moment: I think you said that you felt that the matter of motor competition bore with special severity on the Canadian National?

A. Yes, I did.

Q. Now, I assume that, primarily, it is because of the preeminence, -- if I may put it that way -- of the Canadian National in the east. Would that be the reason?

A. Yes.

Q. That is to say: In the east where motor competition first developed, in any large degree, let us say Ontario and Quebec, and particularly Ontario in the

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in the beginning?

A. Yes, that is right.

Q. So that the effect which you attribute it has on the Canadian National is very largely attributable to that growth in the eastern part of Canada?

A. Yes, largely, yes. I would not say exclusively, but largely.

Q. May I suggest then to you that the Canadian Pacific, if it is pre-eminent in any part of Canada, is pre-eminent in western Canada where motor competition has been a little slower in developing?

A. Oh, yes.

Q. So, are you prepared to forecast that the growth in motor transportation in western Canada will not have, in the future, with the development of roads, an effect parallel to that in eastern Canada?

A. I think it will, yes.

Q. So perhaps I should suggest this to you: That the future really holds quite a considerable threat from motor competition to the Canadian Pacific in an area in which it is pre-eminent, just as you do in the east?

A. I would agree with that; but I would not have it inferred that we are not going to suffer losses in western Canada too.

Q. I am simply balancing up the possibilities of the future.

A. We have, for instance, Nova Scotia; and we have Newfoundland, Prince Edward Island and New Brunswick where we are pre-eminent in service, and the Canadian Pacific, again, has a big area there where we are, by long odds, the pre-eminent railway.

Q. Now, bearing in mind what you say, that motor competition will, quite probably, have a more serious

effect on the Canadian National than on the Canadian Pacific, could I suggest this to you: That in the period beginning about 1930 when, I think, you will agree that motor competition first really became a threat, and 1949, the growth in traffic density measured by net ton miles per mile of line was roughly the same on the Canadian National as it was on the Canadian Pacific?

A. Yes. I think that has been a characteristic of the two properties. I have forgotten the exact year, but I remember Sir Edward Beatty remarking that despite most aggressive competition between the two properties, the net result had been to maintain just about the same percentage of traffic relationship between the two properties over a long period of time; it might vary a little from year to year, but not to any considerable extent. I look upon that as corroborative evidence to my suggestion that that would likely continue.

Q. There is just one other question on that aspect of it. I am sure that we have no basis of disagreement, but I really thought that in your evidence of yesterday or the day before, when you were dealing with the percentage of national product represented by railway revenues, you may have left an impression which either I was wrong in taking, or which perhaps you did not intend to leave. But here is the point I want to make: I think you said that in 1928 railway revenue constituted about 9.41 per cent of the gross national product; and that in 1948 that revenue had declined to about 6.8 per cent of the gross national product.

Now, my first question is: I understood you to say that an adjustment had been made for the rate increases, and I was wondering whether in 1948, this 6.8 per cent you had, included an adjustment for the

increases which have since taken place, or if you merely made an adjustment for the 21 per cent increase which went into effect in that year?

A. It was the rate for that year made applicable to the whole year.

Q. I see. You took the 1948 actual revenue and drew out the increase as reflected to the first of the year?

A. Yes.

Q. My second question is this: Would you not expect that in a period in which inflation has taken place and in which the railway rates lagged behind, or never reached the same degree of increase as prices, generally, that there would be a declining percentage of national product represented by national revenues?

A. Granting your assumptions, yes. I think your conclusion is logical. But at the time I was giving that evidence, I said this was not a spot result, and that there was a discernible trend; and I stated that the percentage in 1928 was 9.4, and that in 1948 it was 6.8; but when adjusted to the rate increases -- and in the intervening years there had been a decline, I mean in those years in which there was no such a thing as inflation. Now, I promised to provide the figures for the intervening years, and I think, if you would like me to do so, I might put them into the record at this point.

Q. I am not particularly concerned with it at the moment. But if you want to put them in, I have no objection.

MR. O'DONNELL: They might as well go in at this point. Perhaps the transcript writer might put them in at this point.

THE CHAIRMAN: Is this to be an exhibit?

MR. O'DONNELL: No, I think the easiest way would be to have those figures included in the transcript at this point.

THE WITNESS: My statement reads as follows:

PERCENTAGE RAILWAY GROSS REVENUES
OF GROSS NATIONAL PRODUCT -- CANADA

Note: In computing percentages, Canadian National deficits have been added to total railway gross revenues.

1928	. . . . .	9.4
1929	. . . . .	9.2
1930	. . . . .	9.2
1931	. . . . .	9.4
1932	. . . . .	9.5
1933	. . . . .	9.5
1934	. . . . .	8.8
1935	. . . . .	8.3
1936	. . . . .	8.1
1937	. . . . .	7.5
1938	. . . . .	7.6
1939	. . . . .	7.3
1940	. . . . .	6.6
1941	. . . . .	6.4
1942	. . . . .	6.3
1943	. . . . .	6.9
1944	. . . . .	6.7
1945	. . . . .	6.6
1946	. . . . .	6.1
1947	. . . . .	5.9
1948	. . . . .	5.9
1948	(adjusted to allow for rate increases)	6.8

This is a statement of the percentage of railway gross revenues to the gross national product; and in computing percentages, Canadian National deficits have been added to total railway gross revenues. And then the figures follow, and the trend which I mentioned is discernible because in 1937 we dropped down to 7.5; and in 1939 we dropped to 7.3; I do not consider the war years as being particularly indicative, but it is an indication that the unadjusted figure in 1948 was 5.9 and the adjusted figure was 6.8.

(Page 20367 follows)

MR EVANS: Q. On that may I put it this way to you, that the rate increase in 1948, in view of the wage increase that took place in that year, was not sufficient to restore the imbalance as between rates and costs in that year, and in the result there was actually in 1948 an imbalance, and that figure of 6.8 might have still further been increased had there not been a lag in getting a further increase?

A. Oh, I think that is a fair statement, but I do not think---

THE CHAIRMAN: Had there not been what?

MR EVANS: Had there not been a lag in getting a further increase.

THE WITNESS: But I cannot escape the conclusion that there is a declining characteristic, and I am not going to argue what the exact amount is, but there is a declining characteristic. It is noticeable in the Canadian economy; it is particularly noticeable in the United States economy, and it is a very serious thing for the railway industry.

MR EVANS: Q. I am not quarrelling with you on that. I wanted to get cleared up just what you did mean, because the note I took -- and I think the transcript rather bears this out -- is that you used the words "purely and simply", as indicating that this whole difference was due to this motor competition, and I did not want to leave that on the record.

A. Oh, well, I may have over-emphasized that point, but I do not think I over-emphasized it to such a degree that it vitiated the broad conclusion. I maintained then, and I still maintain, that the chief reason for this declining characteristic is this erosion that is taking place by highway transport into the railway traffic on an

uneconomic basis. That is the fundamental and to me crystal-clear conclusion.

Q. Now, when you say the chief reason, I must go back to you, because if you look at the figures in the table that you put in you will find that, despite the fact that there was motor competition developing in the early thirties at quite a rate, your proportion of the gross national product represented by railway revenue was actually increased, so that I do not think you could suggest that in the reverse case, where you have inflation instead of deflation, if I might use those terms, there would not be at least a measurable part of that due to the fact that railway rates do not increase as rapidly as do prices generally?

A. Well, of course, we might just have a difference of opinion on that.

Q. I would like to get your view.

A. Well, if you want my view, I wonder if I might hear exactly what you wish my view on.

MR EVANS: Would you mind reading the question?

THE REPORTER: "Now, when you say the chief reason, I must go back to you, because if you look at the figures in the table that you put in you will find that, despite the fact that there was motor competition developing in the early thirties at quite a rate, your proportion of the gross national product represented by railway revenue was actually increased, so that I do not think you could suggest that in the reverse case, where you have inflation instead of deflation, if I may use those terms, there would not be at least a measurable part of that due to the fact that railway rates do not increase as rapidly as do prices generally?"

A. Well, I look at my statement, and I see in 1928 it

was 9.4, I find that in 1932 and 1933 it increased one-tenth up to 9.5, then it started showing declines -- 8.3, 8.1, 7.5, 7.6, 7.3, and then 6.6, the first year of the war. Now, I think that it is clearly evident that this 6.8 figure -- it is hard to conceive that it could possibly be any higher than the 1939 figure, which is 7.3, so I maintain that my premise or my conclusion still stands.

Q. Well, all I wanted to get clearly understood was that at all events the fact of inflation in prices, unaccompanied by an equal increase in rates, would be expected to reduce that percentage?

A. Yes, but I cannot be -- I do not want to pursue the thing unduly, but I cannot be sure that this element of inflation is not lagging behind other elements of the economy. I cannot tell. We cannot say that everywhere except in the railway rates inflation is keeping pace with changing conditions. It certainly is not keeping pace in some of the things in my private life.

Q. Then, if I might pass on---

COMMISSIONER INNIS: That could easily be remedied.

THE WITNESS: I wish it could.

MR EVANS: Q. Before I leave this question of the two things, competition and inflation, which you say are going to bear with greater severity on the Canadian National than on the Canadian Pacific, I think it is quite clear to this extent, that what you said was that those factors were taken into account in arriving at this figure of \$300 million relief which was a part of your capitalization proposal?

A. Oh, decidedly.

Q. So may I suggest this to you, that if you discount those by providing in effect \$9 million to meet them, one then puts the Canadian National on a basis of parity at least

for the future, having discounted those special conditions?

A. Parity with what?

Q. Parity with the Canadian Pacific.

A. To a degree, yes, but I maintain, as I have stated, at a lower level. That is, the relief that should be granted to the Canadian National if you wanted to look at it from the point of view of exact parity with the Canadian Pacific in all its aspects would have to be much more substantial than is here asked for. We have not asked for any more reduction of our fixed charges than will give us a reasonable chance of avoiding deficit operation. That is the modest position we have taken.

Q. I think perhaps it is my fault as much as yours, Mr. Fairweather, but really what I was discussing was this particular matter of competition and inflation. What I understood you to say was that those two things bore with particular severity on the Canadian National, and when you speak of particular severity I assume you mean as compared with its competitor, the Canadian Pacific. Now, as I understand what your evidence was, you took into account those matters which bore with particular severity in arriving at your \$300 million figure, which in effect either gives you \$9 million by way of new revenue through interest or reduces your fixed charges by a similar amount in future?

A. Yes, but we did not take that \$300 million into account specifically for those purposes. We took the whole of the \$1,060 million, the \$760 million plus the \$300 million. That is the sum total of the relief we were asking for, and I cannot segregate out of it so much for this and so much for that. We took the whole field of our managerial activity as we saw it in the future against the perspective of the past, and, having measured as far as we could by our judgment the discernible trends, we said we need \$1,060 million relief of fixed charges. That is the only answer I can pos-

sibly give to that question.

Q. I have not got the place in the transcript, but if you left the impression that these two things that I have spoken of, which bear with particular severity on the Canadian National, were taken into account in reference to the \$300 million, you do not adhere to that now?

A. I never said that it referred to the \$300 million, at least I do not recall that I ever said that.

Q. My recollection was that you did.

A. Well, then, if I did I was certainly not speaking what was in my mind, because there is no division between the \$300 million -- I would like to make this perfectly clear---

Q. I do not suggest there was.

A. There is no division between it and the \$760 million. It is simply that in total we wanted relief enough to keep us out of a deficit position, and we said \$760 million may be obtained here and another \$300 million is necessary to add up to the total of what we consider is necessary to accomplish the purpose we are after.

COMMISSIONER INNIS: I wonder if I could interject, Mr. Evans, to ask what is meant by Canadian National deficit being added to total railway gross revenue.

THE WITNESS: Well, the point, sir, was this, that obviously these deficits in a sense are revenues to the Canadian National. We apply to Ottawa, you see, by certificate and we get that in. Now, I put it in the statement because I wished to get some sort of consistent pattern. It is what the people of Canada pay for transportation services either through railway rates or through the deficit of the Canadian National.

MR EVANS: I have just one or two questions I think, to ask now. I think I shall be able to finish by one o'clock.

Q. Have you had a chance to look at Exhibit 271 and to decide whether or not those figures do include the Other Income of the Canadian Pacific?

A. Yes, and I find they do include the Other Income of the Canadian Pacific. It might be debatable whether they should be included or whether they should not, but I stated, and I have confirmed the point, that substantially the same result can be found if you take the net revenue from railway operations, which is the major part of what I am looking at, and I have had those figures abstracted, and if it is desired I could file them. They simply show -- now, wait a minute. Are these the correct differences? I see they have not got the statement entirely finished, but the statement shows substantially the same figures.

MR O'DONNELL: I think it would be convenient if we put them in separately.

MR EVANS: I am not concerned about/ that. I just want to point this out to Mr. Fairweather.

Q. If you deduct, taking the year 1948, the Other Income of the Canadian Pacific from the figure of \$43,284,115, you will find that the net rail earnings were \$18,419,166, and that difference in the difference column of \$30,781,000 becomes \$5,916,235?

A. Well, I would have to see the figures on that. I think if you take net revenue from railway operations---

THE CHAIRMAN: Q. In connection with the Canadian National, then, is there nothing there that could be called Other Income?

A. Well, that is the point, sir. You see, our income account is a consolidated income account, and we include in it every bit of our activities, and the Canadian Pacific does not. Now---

Q. Give me an instance of what you have in mind?

A. Well, for instance, in the Canadian National income account you will find the results of operation of the Rail and River Coal Mine in the United States, and you will find the results of a warehousing company in Montreal; you will find things of that character. Everything is put into our consolidated income statement, and we have only one income statement. We have nothing in the nature of a special income. It is all shown in the income account of the railway.

Q. What about hotels?

A. That is shown in the income account of the Canadian National.

MR EVANS: Q. I think it would be fair to say, Mr. Fairweather, that your Other Income is very much smaller than ours?

A. Well, that is true, but nevertheless ours is on a consolidated basis, and we so report. But the main point I wish to make in this submission was that there are inherent differences between the earning capacity of the Canadian National and that of the Canadian Pacific arising out of the difference in traffic density, and that is very substantial in peacetime, and I would not want that fact obscured, because it is a very substantial thing. All you have got to do to prove it is to consider this figure of 2,383 miles additional railway that we have to operate for the same traffic density. You cannot operate a railway today at less than somewhere around \$8,000 a mile, and you see there you get \$20 million difference. We have the burden of that operation without any offsetting revenue.

MR O'DONNELL: My understanding, my lord, is that Exhibit 218 and Exhibit 232, which are respectively the D.B.S. returns for the Canadian National Railways and the Canadian Pacific Railway, are prepared on a basis which

permits strict comparison of, for instance, net operating revenue, and that is the stencil that we will have cut and prepared and filed as Exhibit 272.

MR EVANS: In order to make it perfectly comparable -- I do not care whether my friend does it or not, but, since the witness has drawn attention to the fact that some Other Income is included in their figure, perhaps it would be wise to remove it from both.

MR O'DONNELL: I am quite satisfied to accept the official returns as made by the Canadian Pacific Railway to the Dominion Bureau of Statistics, and that is what for the purpose of this computation we will have on Exhibit 272.

MR EVANS: Q. Now, I am very nearly through, as I am sure you will be glad to hear, Mr. Fairweather. There was one part of I think it was the cross-examination by a provincial counsel in which you spoke of the rule of thumb method -- perhaps it was Mr. Covert -- the rule of thumb method for arriving at whether rates could be considered as compensatory. Do you recall that evidence you gave?

A. I think I---

MR O'DONNELL: Could you give us the page reference?

MR EVANS: I have not got the page reference.

MR O'DONNELL: 20167, is it?

MR EVANS: 20167, yes.

Q. The beginning of this discussion with Mr. Covert was related to a question in which he asked you whether you considered it a fair test to apply car mile and ton mile earnings in arriving at whether rates were compensatory or not, and I think your answer was that you have developed skills in costing analysis, and you could not say categorically that revenue per car mile or revenue per ton mile is in itself a criterion, and I think you also at some stage --

and you can correct me if I am wrong -- rather deprecated the use of those rule of thumb tests for testing the compensatory nature of rates. Am I correct in that?

A. Yes, I did. I do not deny that if the revenue per car mile is above a pretty substantial figure it removes all doubt as to profitability, but what I have done in cases like that is this: The Traffic Department of the Canadian National and also the Purchasing Department, because they also have need to use similar figures in the distribution of coal, have asked me on many occasions if I could furnish them with a rule of thumb method by which they could judge the cost of a movement, and I have consistently refused to furnish them with such a rule of thumb method, because I think these rule of thumb methods are highly dangerous in the hands of people who are not skilled cost analysts.

Q. But, at all events, I think you will agree with this, that the Interstate Commerce Commission has used it very extensively in determining the lower limits below which rates must not go to be compensatory, and they use the car mile and ton mile earnings?

A. Well, I know they use rather an elaborate system of costing; I know that.

Q. Well, do you not also know that when determining whether a rate may be put in to meet competition they must not be below a certain yield per ton mile and per car mile?

A. Yes, I know that.

Q. All I am suggesting to you is that a traffic man, a busy traffic man, sitting at his desk and being asked continually to decide whether a rate should be quoted or not, would find that test of great value as long as he found that, for example, the average car mile earnings of the entire system were being earned in a particular

area with a reasonable ton mile earning as well?

A. Well, even that might be in error, but it would be a fairly safe assumption.

Q. All I am suggesting to you is, as a practical matter, if he found that the ton mile and car mile earnings were well below the average, or even below the average, he might have to look at them, but the difficulties of these cost analyses, as I am suggesting to you, do not lend themselves to a day-to-day use of such methods in a traffic department?

A. Well, we have an organization that can give information to our Traffic Department very promptly, but I quite agree that in the practical working of the Traffic Department every rate change is not referred to us for analysis. What they do refer to us is all the cases where they think there is danger that they may be unprofitable.

Q. Well, I think that is exactly the practice we follow, and I just wanted to clear it up. Thank you, Mr. Fairweather.

THE CHAIRMAN: I may say that this afternoon we intend to adjourn at four o'clock.

---The Commission adjourned at 1:00 p.m., to meet again at 2:15 p.m.

Ottawa, Ontario
April 21, 1950.

A F T E R N O O N S E S S I O N

S. W. FAIRWEATHER - Recalled

EXAMINATION BY MR. COVERT:-

MR. COVERT: Mr. Chairman, there were two points that arose that I thought we might get a little clarification on arising out of the examination by Mr. Brazier about passenger traffic, and the other arising out of Exhibit 271. I thought we might get a little information that might be of use to the Commission.

Now, on the question of passenger traffic, Mr. Fairweather, I just want to find out if we could put it in simple language of this kind: You would say that on the whole passenger traffic certainly does not carry its fair share or make its fair contribution to railway operating income?

A. Well, put in just that way, I find it difficult to determine what is fair and what is unfair. I can certainly say this, that passenger revenues are not sufficient to pay all of the costs that may be allocated to passenger traffic. That, I can say.

Q. Would you say that the passenger traffic is such that the railways worry a great deal about it?

A. Well, I know the Canadian National worries a great deal about it.

Q. Yes? It seems to me that in the Interstate Commerce Commission decisions the Commissioners are almost unanimous that passenger traffic does not pay its way, but it is something that the railways must continue.

A. I think that is a fair statement, yes. I think if you define "by paying its way" that it should pay all of the expenses that might be allocated to passenger service certainly we do not get enough revenues to do any more than that at the very best picture that I have ever been able to make.

THE CHAIRMAN: Do you get enough revenue to recoup your expenses?

A. Well, I doubt if we do.

MR. COVERT: Q. Well now, I want to discuss with you, Mr. Fairweather, the question of the abandonments of passenger services. What I am suggesting to you, and I want you to correct me if I am wrong, there must be many services in sparsely populated areas that you would like to abandon, that is, many passenger services?

A. There are many passenger services that do not come even within shooting distance of meeting the expenses incurred, and these are mostly to be found in sparsely settled areas.

Q. Yes. And as a matter of fact I think you have discussed the question of your applications for abandonments, and have pointed out, I think, that the Board has adopted the attitude that the balance is in favour of necessity and convenience even though the railways may operate them at considerable loss and they have in many cases said necessity and convenience to the public overcomes the losses suffered by the railways in carrying out these services?

A. Yes, I think that is a true statement.

Q. Mr. Fairweather, would you say this, that there perhaps should be something that would help the railways in modifying the effect of this convenience to the public?

A. Well, if we had a broad national transportation policy that would enable public convenience and necessity to be argued before a competent tribunal having jurisdiction over all of the services, I think it would be very helpful. What we have found is this: We operate a passenger service authorized and directed by the Board of Transport Commissioners, then we find the Provincial Transportation body will authorize a bus operation in the same territory. We go to that Provincial authority and we say, you should not authorize this operation because national convenience and necessity requires the railway to operate a train service. It is the only medium of transportation that can furnish an all-weather service to the community and it is unfair to the railway that it should find a condition in which it has to maintain services and maintain equipment that practically nobody uses in the summer time, and then in the winter time when the roads are closed or at such times in the spring and fall as buses are not permitted to operate on the highway, everybody turns to the railway for a period. The general attitude of the Provincial bodies has been that they recognize this as a problem, but it lies beyond their jurisdiction. Similarly, when we go to the Board of Transport Commissioners and say, here is a situation, all of our traffic or practically all of it has been diverted to the highway, and we desire either to withdraw completely from the passenger service, or to make a co-ordination with a highway service which would effect economy, we find the Board of Transport Commissioners very reluctant to grant us the desired authority.

THE CHAIRMAN: Q. You talk about authority to connect with what?

A. Oh, no, they would have no authority.

Q. What is it you said about authority?

A. The authority to discontinue the passenger train service.

Q. Yes, but before that you said something about co-ordinating.

A. I said, if we desired to co-ordinate with a bus operator.

Q. What is to prevent that?

A. To make the co-ordination of any value, we have to get permission from the Board of Transport Commissioners to abandon the train service, and we have to file an application with the Board of Transport Commissioners to abandon the train service, and then, when we make that application, people will appear and make representations to the Board and say "Oh, no, we do not ^{want} this train service abandoned", and the Board then examines into the situation, and in one recent case, after a great deal of discussion, they finally agreed to give us a temporary permission for, I think, a six or seven month period.

Q. That is for abandonment?

A. Yes, the abandonment of our service, and the substitution for it of a co-ordinated bus service.

Q. Co-ordinated with the railway?

A. Yes, sir. Co-ordinated with the railway, yes, connecting with our main line trains.

And I believe that one of the points there, is the fact that the Board of Transport Commissioners

had before them an issue of public convenience and necessity as evidenced by witnesses coming forward and saying we want the service, and they have no jurisdiction over the provision of the bus service, that being a purely provincial matter. Therefore, you get the Canadian National, so to speak, caught between two fires: the Provinces/^{say} we refuse to look at national convenience and necessity, we will only look at the local picture, and the Board of Transport Commissioners saying we have no jurisdiction over the highway picture, and because there is public convenience and enecessity by rail, we tend to feel that the railway service must be continued. Now, I think there is a field where a national transportation policy could be worked out, and I think that the duplication of service between highway bus operation and railway train service could be materially lessened to the general advantage of the transportation economy.

COMMISSIONER ANGUS: Q. Do you find the situation appreciably easier in those provinces that regulate buses and trucks?

A. Well, all provinces regulate buses, and some attempt to regulate trucks. The regulation of the bus is ever so much easier than the regulation of the truck. I do not know of any place where the trucks are what you would call effectively regulated in Canada, or the United States for that matter.

MR. COVERT: Q. Perhaps you could answer Dr. Angus's question just with respect to the buses. Do you find it easier where the buses are regulated? You say they are regulated everywhere, therefore, there is no question whether it is easier or not unless the answer might be since buses have been regulated do you find/^{it} easier?

A. I can tell you some interesting incidents. We selected a community in Nova Scotia, an area in Nova Scotia. We also selected an area in Quebec. We went to the communities, we thought if we went to the communities and got in touch with the people, that we might be able to get some unanimity of answer by the people as to whether they wished the duplication or whether they did not. We put on a real canvass of public opinion as represented by Boards of Trade and Town Councils, and we were successful in both areas in convincing these bodies that there was merit in the idea of providing the railway service with protection in the national interest and in the interest of the community. That did not prevent, however, the granting of bus licenses, although we presented this evidence to the Provincial bodies. The result we predicted came about: we said if you will allow us to enjoy the traffic, we will provide, continue to provide a high quality of passenger service; if however, the railway is faced with an increasing diversion of its passenger business, we will simply be forced to reduce the quality of our passenger service, and that was the outcome.

Q. Now, if you consider this that some power might be given to the Board of Transport Commissioners that they could say, well, now, regardless of whether or not we have control over the bus service which is supplied, we will look at the situation and see if that satisfies public necessity and convenience and in such case, even though we have not control over that, we will authorize abandonment.

A. Well, we have always taken that view before the Board, and it would certainly be most helpful.

Q. Well, you say you have that power now?

A. We have the power to appear before the Board of Transport Commissioners and argue that way and we do, but all I am saying is, we continue to operate a good many services that are uneconomical. Now, you take this situation in the Province of Prince Edward Island where we worked out a very careful/^{ly}planned co-ordinated service. If the Province indicates that they are willing to make use of it, we will have to go to the Board of Transport Commissioners and get authority to abandon our passenger train services. But, to answer your question, sir, I think it would be highly desirable if some such arrangement could be worked out. That is what I mean by a national transportation policy.

Q. In connection with the Prince Edward Island proposal, it might be conceivable, Mr. Fairweather, under the circumstances as they exist now, that if you had agreement with the Provincial Government and you had your plan all worked out, that you might go before the Board of Transport Commissioners, and then, if individuals protested abandonment your plans might not materialize?

A. That is true.

(Page 20387 follows)

Q. The next thing I want to take up with you, Mr. Fairweather, is Exhibit 271, which was filed this morning. Have you got a copy of it?

MR. O'DONNELL: I now tender Exhibit 272.

EXHIBIT No. 272: Filed by : Comparison of
Mr. O'Donnell: net operating
revenues --
Canadian Pacific
Railway Co. and
Canadian National
Railways
(Authority -
Exhibits 232
(CPR) and
218 (CNR).

THE CHAIRMAN: What is it?

MR. O'DONNELL: Exhibit 272 is entitled
"Comparison of net operating revenues - Canadian Pacific
Railway Company and Canadian National Railways
(Authority - Exhibits 232 (CPR and 218 (CNR).

MR. COVERT: Q. Perhaps, first of all,
Mr. Fairweather, could you explain to me just the dif-
ferences between Exhibit 272 and 271. Let us just take
the first year, 1923.

Now, in Exhibit 271 it showed the net income
before fixed charges of the Canadian Pacific as being
\$48.9 million, and of the Canadian National, \$15.2.

Now you show in Exhibit 272 for the same year
net operating revenues, and in that case the figures
are \$40.3 million and \$21.1 million?

A. Exhibit 271, as I understand it, is the
corporate result of the Canadian National and the
corporate result of the Canadian Pacific before fixed
charges.

Q. Yes?

A. And Exhibit 272 is only a part of the income
account of the railway operations themselves adjusted
by the Dominion Bureau of Statistics to a comparability

between the Canadian National and the Canadian Pacific. There are many other income items before fixed charges which do not appear in Exhibit 272, many of them. But Exhibit 272 shows a comparison at the level of net operating revenue.

THE CHAIRMAN: Q. Would you say that is all rail revenue?

A. That would be rail and allied services revenue and expenses. It includes express, for adjustment purposes, and also, I think, telegraphs.

MR. O'DONNELL: It might be well to draw the attention of the Commission to the fact that that data is taken from Exhibit 232, page 6, the third column, in so far as the Canadian Pacific is concerned, and with respect to that table 2 there is a note on page 4 which says, "

"Table 2 shows the operating results of the system for the twenty-six years 1923 to 1948 adjusted, as explained in footnote 2, to be comparable throughout with data prepared and presented in the Duff Report, putting the Canadian Pacific and the Canadian National accounts on a basis as nearly similar as possible. Consequently operating revenues and expenses will not agree with such accounts as shown in the Annual Reports."

Footnote 2, which is referred to in the item I have just read, will be found on page 12; and that footnote 2 says: "includes gross of commercial telegraphs, news, and express, and excludes ocean traffic commission." So the revenue accounts are to be on the same comparable basis, or basis of comparability that they were in the Duff Report; and that data, in so far as the Canadian

Pacific is concerned is in Exhibit 232, and for the Canadian National, in Exhibit 218.

MR. EVANS: Lack of comparability is principally due here to the fact that the income tax of the Canadian Pacific has not been deducted, as I see it.

THE CHAIRMAN: You say it has not been deducted?

MR. EVANS: Yes.

THE CHAIRMAN: You mean in Exhibit 217?

MR. EVANS: I know that we have never had a net income from rail operations of \$84 million in our history, and I suggest there is at least the matter of income taxes, and, as my friend has said, telegraphs, which we do not include rail revenues at all. I cannot check these figures.

MR. O'DONNELL: Well, I simply rely on the note given in the official publication of the Dominion Bureau of Statistics which I read. And if there is income tax to be considered, I would have no objection to a compilation being made. But this deals with net operating revenue.

COMMISSIONER ANGUS: Should the Canadian National figures be stepped up in order to improve morale, if we should use this compilation in the future?

A. I would hope that there would be some stepping up. It is certainly the objective of the proposed adjustment of the capital structure, and I think it would be fairly substantial. Now, it is because of that, sir, that I do not agree with this idea: that we were just on a flat zero. I think we do have a challenge to us to increase our efficiency.

MR. COVERT: Q. As I read Exhibit 272 and Exhibit 271, Mr. Fairweather, all you have done, or all that is done in these Dominion Bureau of Statistics

reports, it seems to me, is to take operating revenues less operating expenses, and to leave you with a net operating revenue?

A. That is what I said.

MR. O'DONNELL: That is all.

MR. COVERT: Yes. I prefer dealing with Exhibit 271. And if you take Exhibit 271, Mr. Fairweather, I have roughly added just the million figures and the first figures in the hundred thousands, and I have made a calculation, and it shows that in this twenty-six-year period the average net income before fixed charges for the Canadian Pacific has been \$45 million; and in the case of the Canadian National I have added and done it in the same way, and subtracted your years in which there were deficits, and I find that the average was slightly over \$30 million. So that during this twenty-six-year period you have, in one case, an average net income available for fixed charges of \$45 million for the Canadian Pacific, and of \$30 million for the Canadian National.

A. You make that statement, yes.

Q. Yes; and assuming that I have checked it roughly, I have added the differences here in the case of your Canadian Pacific column -- that is the third column -- and subtracted the differences in the last column, and dividing it, I get \$15 million difference; so that should be a pretty fair check.

A. I should say so, yes.

Q. And if that is so, in the case of the \$45 million for the Canadian Pacific, that would be used first to pay fixed charges?

A. Well, yes, I presume so.

Q. Then there would be dividends on preferred stock and on common stock to come out of that?

A. If they paid them, yes.

Q. Well, what I am suggesting is perhaps -- I shall put it this way -- to remain in a healthy condition, would you agree that they should pay fixed charges, dividends on preference and common stock?

A. I have never said they should not.

Q. No.

A. There is no question of that in my mind.

Q. In the case of the Canadian National, your \$30 million would be used for fixed charges first?

A. Yes.

Q. And then the balance -- you would not have to use the balance, for instance, to pay for preference, anything like preference or common dividends?

A. Well, considering the fact that any analysis that I have made of the situation shows there is not going to be a great deal of surplus after fixed charges are made, I think it is relatively unimportant as to what happens to it.

Q. Let us look at it from this viewpoint: I want to find out -- let us develop it like this -- here in the period of twenty-six years the average which would have been available or which has been available for the payment of fixed charges has averaged \$30 million a year.

Now, during that period you have that twenty-six-year period, and you add a ten-year period when you were amalgamating and unifying the lines?

A. Yes, surely.

Q. And then you have a period in the history of the company when you suffered, perhaps, one of the

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world's worst depressions.

A. That is true.

Q. And you also have a period of three years there when I think you suggest that the rates were in imbalance?

A. Yes, that is true.

Q. Now, over further, let us say, a twenty-six-year period, would you say there would be no possibility of an average of \$30 million a year available for fixed charges?

A. No, I would not say that. But in the first place, if I might comment: I thought you made it abundantly clear that the years from 1940 to 1946, or 1945-1946 as a straight year, was something that I could not give at all in the way of forecasting the future.

Q. I suppose that in the next twenty-six years we might have another war in which the same things would occur?

A. I would hope not. Certainly I do not plan that way. I am looking forward, I hope, to a condition where war is not necessary. But even if war is necessary, I feel that the extreme conditions of war are so fundamentally different from those of peacetime that they have no validity as a basis for averaging up or dealing with a forecast of the Canadian National Railways.

The conditions of wartime have to be experienced to be understood; and certainly not one dollar of these things represents anything more than part of the burden of war losses, if we were in a destructive economy, not a productive economy.

Q. Now, Mr. Fairweather, if you take out the war years, that is, the six war years, that still leaves an average of \$19 million for the remaining twenty years?

A. Yes.

Q. An average of \$19 million?

A. And the fixed charges on this adjusted basis in 1949, I think, are \$17 million for the Canadian National.

(Page 20397 follows)



Q. Now, let us see: Could I find out how you calculate that?

A. Well, would you like to know how I got that \$17 million figure?

Q. Yes.

A. Well, I start with our actual fixed charges in 1949, which I find are \$48,631,896. I deduct from that the interest on Government loans, \$21,798,283, and I credit against the fixed charges the interest on the \$300 million fund, \$9 million, so I have a reduction of \$30,798,283. Subtracting that from the actual fixed charges, I get the figure of \$17,833,613.

Q. Now, Mr. Fairweather, have you calculated it in this way, that what you have left in unfunded indebtedness after your proposed reorganization is how many million?

A. Well, if you credit the \$300 million, I think there would be \$283 million of interest-bearing debt, but that is not all of our fixed charges; we have other items, rent for leased roads, interest on unfunded debt, amortization of discount, also to take into account.

MR O'DONNELL: I think Mr. Cooper filed an exhibit showing that, among others, Exhibit 251.

MR COVERT: Q. You would have \$283 million on which the average interest rate would be what, Mr. Fairweather?

A. Oh, well, I have not got that figure here -- yes, I have it here; it would be \$24,302,651 on the whole of the \$583 million. Then from that is deducted the \$9 million on the \$300 million, so that you might say the figure is the difference between the two.

Q. I do not think I am clear on that. What I meant is, if you had \$283 million out of outstanding bonds, in the future you would hope, I think, Mr. Fairweather, to average

about 3 per cent on those, would you not?

A. Well, all I have are the figures in front of me, and they show that the interest on funded debt held in the interests of the public is \$24,302,651.

Q. What I am suggesting to you, Mr. Fairweather, is that some of those bear rather high interest rates, which you hope, I think, to perhaps---

A. Yes, but that is the situation as it stands in 1949. Now, the future is a sort of unknown book. I do not know what will happen. Five years from now we may be paying 6 per cent for money or 2 per cent for money, but I am stating the situation as it exists, and I think I am stating it correctly, that the adjusted fixed charges of the Canadian National Railway in 1949 would be \$17,833,613. There seems to be some difference between the figures that I am using here and Exhibit 246, but I do not think they are material.

MR O'DONNELL: Whatever the figures are, Mr. Cooper gave the exact figures.

MR COOPER: Q. Mr. Fairweather, may I put it to you this way, then: You suggest that a fair figure for the immediate present and for a pretty fair forecast for the future is fixed charges of about \$17.8 million?

A. Somewhere in that neighbourhood -- \$17 million, say.

Q. Then, as I say, you would prefer to deal with Exhibit 271 on the basis that you would eliminate altogether the six years of the war, and then taking the average of approximately \$19 million, you say that that shows that with a balance of about \$1.2 million that would be your surplus?

A. Oh, I would not go that far. There are many other things that have to be taken into consideration. That is only one side or one phase of the matter. There are all kinds of other things that have an effect, some good, some

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bad, but so far as the historical record can be relied upon to be a judge, that would be approximately the result. But I do not think that historical record is necessarily the complete criterion.

Q. I wanted to ask you this: Do you think that the historical record which if you adopt that method leaves you with the three latter years in which the rates were in imbalance, a period of at least nine years in which, as I say, there was a depression, and then a period before that where you were unifying and reorganizing the system and trying to blend it into one railway operating as a unit -- you think that that would be a fair test, do you, of what average revenue should be?

A. No, I did not say that; I did not say that at all.

Q. Would you say that it was not?

A. I recognize that in this period there are these factors that you have mentioned. I have no doubt that the operating expenses of the property in those earlier years were influenced by the desire to bring the property into a co-ordinated whole; that is undeniable. What is also undeniable, however, is that during those years depreciation was not taken into account, and there are many other things that have to be considered. One of them, if I may say so, in relation to 272, is that the Canadian National does not practise depreciation on fixed property, and the Canadian Pacific does, and that undoubtedly has an effect upon Exhibit 272 in the latter years as shown in that exhibit; but what I am talking about is the Canadian National projected future, and I maintain that there is some hope of our meeting our adjusted fixed charges and leaving a little over, but nothing on the average that would be substantial. That is my position.

Q. Thank you very much.

MR O'DONNELL: Just before we leave that, I would like to draw the attention of the Commission to the fact that the actual figures as the results of operations from 1923 to 1948 are in Table 10, which is page 52 of the main brief, and that the results of operations excluding the years 1930 to 1936 and 1940 to 1946 are to be found in Table No. 4A, which is on page 37 of the main brief.

THE CHAIRMAN: What is your first reference to your brief?

MR O'DONNELL: The first reference is page 52 of the main brief, which gives the results of operations for the entire period 1923 to 1948, breaking it into a series of groups, with the averages from 1923---

THE CHAIRMAN: And what is the second reference?

MR O'DONNELL: The second is page 37 of the main brief, being table No. 4A, and then the re-stated basis, the results of operations on a re-stated basis, giving effect to these changes, will be found, I think, in Exhibit 251.

THE CHAIRMAN: Does anybody else wish to question Mr. Fairweather? (No response).

Well, we thank you very much, Mr. Fairweather.

Now, what is next, Mr. Covert?

MR COVERT: Have you finished the Canadian National case?

MR O'DONNELL: Yes.

I just have a statement here I would like to file, and, rather than take the time of the Board in reading it, I will ask the reporter to have it put into the record. It is a short statement furnished to us by the Operating Department, concerning the Borden-Tormentine Ferry Service. It gives details as to the extent of the

service and the schedules of operation, train and boat, and so on. I think it would save time if we just had it taken into the record.

MR FRAWLEY: Is that the new ferry as announced in the paper today, putting on a second ferry?

MR O'DONNELL: No. That ferry is referred to, but this statement has nothing to do with the statement you refer to. I happened to hear the Minister yesterday making the statement in the House, and he said that during the summer months this year they have agreed to experiment with the operation of two ferries during the tourist season, on the assurance from those who asked for the service that the additional revenue to be derived from the operation of the second ferry would more than pay for the expense; and the Minister stated that in those circumstances they would experiment with the proposition for one year, keeping separate accounts to see exactly what the result was, and if it was adverse it would not be renewed next year.

THE CHAIRMAN: That will be good news for Mr. Campbell.

MR O'DONNELL: Yes, that will be good news for him, I think. Sorry he is not here to hear it.

(Statement re Borden-Tormentine Ferry follows on p.20402)

CANADIAN NATIONAL RAILWAYS
STATEMENT RE BORDEN-TORMENTINE FERRY SERVICE

The Car Ferry M.V. "Abegweit", the principal ferry in the Borden-Tormentine service was completed in 1947 at an approximate cost of \$6,564,000. She is a motor vessel of 6,694 gross tons (3,605 net tons) and is described as the largest and most modern ice-breaking car ferry in the world. She has a capacity of 19 freight cars and 69 automobiles. She was designed to carry ten 30,000-lb. buses on the aft auto deck. Buses, however, cannot use this space, even if it were considered desirable to make this space available to them because of the limitation of the ramps at both Borden and Cape Tormentine. The auto deck was not designed for trucks of 30,000 lbs. as these have 80% of their weight on the rear axles. Both buses and trucks up to 30,000 lbs. are carried on the rail deck. Automobiles are also carried on the rail deck when there is space available and the necessity arises.

The "Abegweit" was placed in the Borden-Tormentine service on August 14th, 1947, and has been in service continuously since with the exception of time out of service for her annual overhauls in drydock at Montreal (May 7th, 1948 to June 24th, 1948, and April 27th, 1949 to June 1st, 1949).

Since August 14th, 1947, there has been but one occasion when the "Abegweit" was not able to move each day all the freight cars offering. This single occasion resulted from an accumulation of refrigerator cars following a temporary shortage. The backlog, not in excess of 200 cars, was cleared up on the following week-end. None of this accumulation was on hand for more than three days.

1. The first part of the paper is devoted to a general discussion of the problem.

2. The second part is devoted to a detailed study of the case of a single particle.

3. The third part is devoted to a study of the case of a system of particles.

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16. The sixteenth part is devoted to a study of the case of a system of particles.

The "Abegweit" has not only handled all freight traffic which has been offered to date, but is capable of handling all the foreseeable traffic in the future. Furthermore, this has and will be done without operating a full 24-hour day, excepting during the months of November and December when the heaviest volume of potato traffic is moving. During these months it is necessary some days to operate continuously for 24 hours. Seven round trips are the maximum which can be made within 24 hours, including the meeting of scheduled trains. On Sundays when there are no scheduled trains, eight round trips can be made. In practice, extra trips are made when necessary.

The "Abegweit" (In conjunction with the S.S. "Prince Edward Island" on special occasions such as Old Home Week) is capable of handling all the vehicular traffic offering or likely to be offering in the foreseeable future. There are times that some vehicles must await the next trip, but these have without exception always been handled on the next succeeding trip.

The following was the schedule of the ferry service between Borden, P.E.I., and Cape Tormentine, N.B., for the summer of 1949 and is typical summer schedule:

DAILY EXCEPT SUNDAY

From Borden	9:10 AM	From Cape Tormentine	10:35 AM
	1:00 PM		2:40 PM
	4:30 PM		7:30 PM
	9:00 PM		10:30 PM

SUNDAY SERVICE

From Borden	9:10 AM	From Cape Tormentine	10:35 AM
	1:00 PM		3:00 PM
	6:45 PM		8:00 PM

The 9:10 AM and 4:30 PM trips from Borden provided connection for trains 39 and 41 respectively, while the 2:40 PM and 7:30 PM trips from Cape Tormentine provided connection for trains 40 and 42 respectively.

The following passenger train service between the mainland and Prince Edward Island is provided:-

<u>No. 40</u> <u>Ex. Sun</u>	<u>No. 42, Ex. Sun.</u> <u>June 27th to</u> <u>Sept. 6th</u>	<u>No. 39</u> <u>Ex. Sun.</u>	<u>No. 41, Ex. Sun.</u> <u>June 27th to</u> <u>Sept. 6th</u>
11:10 AM 6:10 PM	4:40 PM 10:30 PM	Lv. Moncton Ar. 1:25 PM Ar. Charlotte-Lv. 7:00 AM town	*8:25 PM 2:10 PM

Train No. 40, Moncton to Charlottetown, connects with "The Maritime Express", Train No. 2, from Montreal, with Trains 3 and 59 from Halifax, and during the summer months provides connection on Fridays for "The Pine Tree" from Boston and New England.

Train No. 42 provides connection with "The Ocean Limited" and "The Scotian" from Montreal, also with "The Gull" for Boston.

Train 39 connects at Moncton with "The Scotian" for Montreal, "The Maritime Express" for Halifax and "The Gull" for Boston.

Train 41 connects at Moncton with "The Maritime Express" for Montreal.

Through cars are operated on the above-mentioned train service between the mainland and Prince Edward Island,

but in order to make available the necessary amount of space on the railway car deck of the ferry for freight cars, the passenger train equipment is kept to the minimum necessary to handle the mail and express traffic and to meet the wishes of the Prince Edward Island public with respect to passenger accommodation. The following passenger train equipment is ferried:

TRAINS 39 & 40:-

- 2 Express cars between Moncton and Charlottetown
(Messenger service in one car)
- 1 Express car between Moncton and Summerside
- 1 Combination postal and baggage car
- 1 Sleeping car between Montreal and Charlottetown
(On Train 39 all year; on Train 40 Sept. to June only)
- 1 Coach between Moncton and Charlottetown
(During the summer season only)

TRAINS 41 & 42:-

- 1 Sleeping car Montreal to Charlottetown
(On Train 42 only)
- 1 Baggage car between Moncton and Charlottetown
(For through mail, express and baggage)

Through sleeping car service is provided between Montreal and Charlottetown to meet the wishes of the Public. During the mid-summer period these cars are reasonably well patronized by through passengers, but for the balance of the year through travel between Upper Canada and the Island is negligible. However, the car is utilized for traffic between Montreal and Moncton and

intermediate points, and was simply extended through to Charlottetown to meet the wishes of the Prince Edward Island Government.

It will be noted that headend cars are operated through between the mainland and the Island for the accommodation of express, mail and baggage traffic. There is a substantial volume of express traffic, also Government Mail Traffic. If the operation of through equipment was discontinued it would be necessary to trans-ship all of this traffic at Borden and Cape Tormentine, resulting in extra handling and consequent delay.

In the case of the mail car, this is a 30-foot postal car equipped for sortation service with Mail Clerks. These Mail Clerks are fully employed in sortation work while the postal car is being ferried, in order to have the mail available for distribution to the various routes when the car reaches the Island or the mainland.

The necessity of tying in the ferry schedule with train schedules seems obvious. Apart altogether from the passenger traffic which assumes some proportions during the summer months, there is the necessity of moving express, mail and baggage as promptly as possible. While train and ferry schedules, looked on as a whole, maintain a reasonable on-time performance, there are delays to the ferry during the summer months occasioned by the necessity of providing a connection of the summer train No. 42 with "The Scotian" from Montreal. This latter train does local work between Montreal and Moncton, handling passengers, mail, express and baggage for all Maritime points including P.E.I. The volume of traffic is such that, during the summer months, "The Scotian" experiences some delay. This in turn means a delay for

No. 42, which in turn causes a delay to the ferry.

The S.S. "Prince Edward Island" was completed in 1915 at an approximate cost of \$707,000. She is of 2,795 gross tons and 1,110 net tons. She is also an ice-breaking car ferry, and has a capacity of 12 freight cars and 40 automobiles. While this ferry is 35 years old, it has been maintained in first class condition. She operates in ferry service while the "Abegweit" is in drydock for her annual overhaul and on the few occasions when additional service is required. Most of the time she is standing by at Borden. Like the "Abegweit" her railway deck is available for automobiles when she is not carrying her full capacity of freight cars.

In the unlikely event of a complete breakdown of service, one of the ice-breaking car ferries in the Mulgrave-Point Tupper service is available. The S.S. "Scotia No. 1", which has a capacity of 18 freight cars (automobiles have to be loaded on flat cars) relieves the S.S. "Scotia No. 2" in the Mulgrave-Point Tupper service. While an older ship, the S.S. "Scotia No. 1" is still serviceable and was, in fact, used to relieve the S.S. "Prince Edward Island" when the latter was in drydock for her annual overhaul. This was in 1947 before the "Abegweit" went into service.

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THE CHAIRMAN: You have finished now with the Canadian National case?

MR O'DONNELL: Yes, my lord, at this point.

THE CHAIRMAN: Very well, Mr. Carson.

MR CARSON: May it please the Commission:

The position of the Canadian Pacific with respect to the review of the capital structure of the Canadian National has been stated in paragraphs 54 and 55 of the outline submissions that are found on page 109 of Part I of the Canadian Pacific submission, and also by Mr. Evens in the introduction of his cross-examination of Mr. Cooper, at page 18916 in volume 102 of the proceedings here.

Now, my lord, in keeping with that position, the Canadian Pacific deemed it advisable to have the proposals for recapitalization of the Canadian National examined by experts of outstanding qualifications in the fields of finance, accounting and economics, in order to determine the effect of such proposals upon the Canadian Pacific; and it was felt that there was a simple duty owing to the shareholders of the Canadian Pacific as well as to your Commission to put before your Commission the results of those studies and the conclusions that have been reached.

Each of those experts has prepared a statement of his views to be submitted to your Commission, and copies of these statements have been furnished to Mr. O'Donnell and to Mr. Covert and to counsel for the interested parties.

In presenting these statements to your Commission I want to make it perfectly clear that Canadian Pacific has no intention or desire to project itself into the affairs of the Canadian National beyond the extent it deems necessary for the protection of the Canadian Pacific.

The first statement I would like to present to the Commission is that of Mr. Northey Jones, a partner in

the investment banking firm of Morgan, Stanley & Company of New York. The statements are available for the Commission.

(Page 20411 follows)

MR. CARSON: I call Mr. Northey Jones.

MR. ALLEN NORTHEY JONES, called:

EXAMINED IN CHIEF BY MR. CARSON:

MR. CARSON: Q. I shall ask Mr. Jones to read his own statement including the introductory part which gives a brief history of his experience in the field of finance.

A. My lord: My name is Allen Northey Jones and my home is in Newtown, Connecticut, U.S.A. I am a partner in the investment banking firm of Morgan Stanley & Company. I was graduated from Trinity College in Hartford Connecticut, with the degree of Bachelor of Arts in 1917 and received my Master of Arts from the same institution in 1920. Shortly after my return from France in 1919, where I had been a machine gunner in the 26th New England Division, I entered the employment of J. P. Morgan & Company as statistician, and remained in that position until 1929 when I became head of the Statistical Department, holding that position until 1935. My work was chiefly on railroad financing and financing for governments other than the United States.

From 1920 to 1935 there were approximately \$8,000,000,000 face amount of railroad securities sold to the investing public in the United States, and J. P. Morgan & Company played an important part in the sale of those securities in that they managed or co-managed groups that sold almost a quarter, or about \$1,950,000,000 of this total. As statistician, and then as head of the Statistical Department, my work involved making studies of the earning power and capital structures of many of the important railroad systems in the United States, of their credit positions, and of the

markets for their securities. I worked on the preparation of offering circulars involving descriptions of the mileage and physical characteristics of the railroads, the traffic carried, their financial positions and the indentures securing their bond issues.

In 1933 our Congress passed the Banking Act, which prohibited a company from being in both the commercial banking business and the investment banking business, and in 1934 J. P. Morgan & Company elected to remain in the commercial banking business, which meant that they had to give up their investment banking business. A year later, in September 1935, a number of partners and members of the staffs of J. P. Morgan & Company and Drexel & Company -- they were the J. P. Morgan & Company in Philadelphia -- who had been identified with the investment banking functions resigned and formed a separate independent investment banking firm by the name of Morgan Stanley & Company, Incorporated. I was one of the incorporators of Morgan Stanley & Company Incorporated and vice-president from its formation until its dissolution in December 1941 when Morgan Stanley & Company, the partnership, was formed in which firm I became a partner.

As a vice-president and then a partner in Morgan Stanley & Company I have had under my supervision and direction the statistical and analytical work of the firm. From September 1935 until the end of 1949 Morgan Stanley was the manager or co-manager of groups which purchased and distributed to the public 36 issues of railroad securities totalling some \$915,000,000. In addition to these issues which were publicly distributed, Morgan Stanley, acting as agent, placed directly \$75,000,000 principal amount of railroad securities with

institutional purchasers. Furthermore, Morgan Stanley participated in groups managed by others that distributed some \$8000,000,000 principal amount of railroad securities to the public.

Since September 1935 Morgan Stanley has managed groups which have purchased and offered to the public \$315,000,000 of Government of Canada bonds, and has acted as agent for the Government of Canada in the direct placement with institutional investors of \$150,000,000 of Government of Canada bonds.

Q. Would you pause there, Mr. Jones, to tell the Commission the names of one or two of the Canadian officials with whom you had dealings when acting as agent for the Government of Canada?

A. I have spent more hours with Dr. Clifford Clark, Deputy Minister of Finance, than with any other official in the Canadian Government, and with people in his department. I have also had discussions with Governor Graham Towers of the Bank of Canada and with his people in relation to these pieces of financing.

Q. Yes.

A. In connection with the registration statements filed by the Government of Canada with our Securities and Exchange Commission I had to make a study of the figures of the Canadian National Railway for inclusion in such registration statements. In 1946, our firm with Wood Gundy & Company, a Canadian firm, jointly distributed \$19,500,000 of equipment trust securities for the Canadian Pacific, and in this connection I had to study the operating results of the Canadian Pacific. In February 1949, I was a witness for the Canadian Pacific in the Twenty Per Cent Freight Rate Case before the Board of Transport Commissioners, and shall refer

to certain data in that testimony in this statement.

The Canadian Pacific Railway Company has asked me to appear before you to state what, in my opinion as an investment banker, the effect on the Canadian Pacific would be if the Canadian National were to be recapitalized on the basis of the statement furnished to you March 17, 1950, by the Canadian National Railways, as modified on April 19, 1950, by the statement of counsel for the Canadian National, and if, in addition, the net earnings of the Canadian National, after providing for interest on the reduced basis, are not required to be used to pay a return on the equity capital.

(Page 20416 follows)

At the outset, let me state that, in my opinion, it would be difficult for anyone to oppose the recapitalization of an enterprise with regulated rates if the recapitalization is to bring the capitalization into line with proper valuation of the property. In the United States, Section 77 of the Bankruptcy Act which applies to railroads, provides that the Interstate Commerce Commission in considering plans for railroad reorganizations shall be guided by the provision that "the value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property and the actual investment therein, as may be required under the law of the land in light of its earning power and all other relevant facts."

Under this provision, there have been a number of bankruptcy proceedings in the last eight years which have gone through the lower courts and then up to the Supreme Court for decision. In the Group of Institutional Investors, et al. vs. Chicago, Milwaukee, St. Paul & Pacific Railroad Co. case, the Supreme Court noted that Mr. Justice Brandeis once stated that "value is a word of many meanings".

MR CARSON: Mr. Northey Jones, I would ask you to pause there long enough for me to say that the report of the Milwaukee case in the Supreme Court of the United States will be found in 318 United States Reports---

THE CHAIRMAN: Is that Supreme Court?

MR CARSON: Yes, my lord, 318 United States Reports, page 523; and the passage to which Mr. Northey

Jones is referring will be found at page 540. The decision was given on the 15th of March, 1943.

Now will you go on, please?

THE WITNESS: The Supreme Court continued observing that "it gathers its meaning in a particular situation from the purpose for which a valuation is being made. Thus, the question in a valuation for rate-making is how much a utility will be allowed to earn. The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn." In a number of instances the Supreme Court has said that in railroad reorganization proceedings the most important fact for the Interstate Commerce Commission to consider in valuation is past, present and prospective earning power, but that due consideration must also be given to the investment in the enterprise and all other relevant facts.

Acting under these provisions, and in accordance with the Supreme Court decisions, the Interstate Commerce Commission has approved plans of reorganization in which the valuations of the properties and the amounts of capital securities issued thereunder have been cut down.

MR CARSON: Q. Now you are going to quote from another statement of the Supreme Court, which comes from the same Milwaukee case, 318 United States 523, but this passage or this quotation comes from page 542.

A. That is right.

The Supreme Court has stated that, "a valuation for reorganization purposes based on earning power requires, of course, an appraisal of many factors which cannot be reduced to a fixed formula. It entails a prediction of future events, hence 'an estimate as distinguished from mathematical certitude is all that can be made.'" Thus, a very careful study of earning power must be made before any

drastic scaling down of capital securities. An example of the problems that may arise is furnished by the case of the Chicago, Rock Island & Pacific Railroad reorganization, in which the Interstate Commerce Commission, after detailed studies of all the pertinent factors stated it was felt in a normal year the Chicago, Rock Island would have approximately \$11,000,000 available for fixed charges.

Q. Now, just a minute, Mr. Northey Jones. The decision of the Interstate Commerce Commission to which you have just referred will be found in 242 I.C.C. 298, and the proposition to which you have referred is put at page 437 of that lengthy report.

A. That is correct.

MR CARSON: And the decision, my lord, is dated October 31, 1940.

Q. Now will you go on, Mr. Northey Jones?

A. In the post-war years of 1946 to 1949 the income available for fixed charges has equalled almost twice this estimate. Therefore, in any capitalization of the Canadian National Railway great care must be taken in estimating the earning power of that company so that the scaling down of its capital securities is not too drastic. Furthermore, due consideration must be given to all the other relevant facts, including the value of its property investment and a fair return on such investment.

And I am speaking again from the point of view if there is to be fair competition with the Canadian Pacific.

In this connection, I note that in the December 31, 1949 balance sheet of the Canadian National Railways no depreciation is provided against road accounts, which would seem to indicate that there is room for a recapitalization through the provision of such depreciation reserves. Furthermore, there seems to me to be an inherent difficulty in

establishing the prospective earning power of the Canadian National in view of the Board of Transport Commissioners' opinion that---

MR CARSON: This is from the 8% judgment, of September 20, 1949, at page 11 of the blue copy.

THE WITNESS: -- "it may very well be that the proper basis for establishing freight rates in this country should follow a revision of the capital structure of the Canadian National Railways and the appropriate statutory direction to this Board as to freight rates based on that valuation." It would seem to me to be exceedingly difficult to establish a proper capital structure for the Canadian National based to a large extent on its earning power if in turn the Board which establishes the rates determining earning power is waiting to see what the revised capital structure will be.

It is true that, if an investment banker were advising with a commercial enterprise as to the proportions of capital that should be represented by fixed interest securities (and I emphasize the word "fixed") he certainly would not recommend as great a proportion of fixed interest securities, as is the case now with the Canadian National Railways. He would, however, expect a recapitalization under which each class of securities would in normal times earn and pay a return to its owners.

If, then, it is reasonable for the Canadian National Railways to recapitalize, is the effect of the plan as presented on March 17, 1950, as amended on April 19, 1950, one that is apt to imperil and possibly bankrupt the Canadian Pacific Railway?

I assume that it is the desire of the people of Canada that the Canadian Pacific Railway shall continue to operate and furnish transportation service as an enterprise

owned by investors in Canada and other countries alongside of, and in competition with, the Canadian National Railways owned by the Government of Canada, and that rates and various other matters should be subject to regulation by duly constituted Government commissions.

If the Canadian Pacific Railway is to continue to furnish transportation service, the people of Canada will want it to be a strong, healthy and dynamic transportation agency because certainly a stagnating or declining enterprise cannot furnish modern transportation at the lowest costs. To furnish improved service and to be able to offset some of the increased costs of labour and materials, it is necessary to make improvements, additions and betterments to the property and to find the money to make such improvements. I refer to such items as the acquisition of Diesels, the conversion of locomotives from coal burning to oil burning, the reduction of grades, the mechanization of maintenance work and rearrangement and modernization of yards.

Two months ago I made an inspection trip over the Atlantic Coast Line Railroad Company with the president of that company, as our firm has been retained to arrange and manage an exchange offer whereby holders of \$50,724,000 principal amount of non-callable bonds of that railroad, due in 1952, are now being offered the opportunity to exchange their bonds for new mortgage bonds maturing in 1980. The Atlantic Coast Line presented us with data showing that in the ten years 1939-1948 they had purchased 189 diesel units (road freight, road passenger and switching service) at a cost of approximately \$26,600,000 and that they estimate that their savings are about \$7,300,000 a year (based on operations for 1948) because of this substitution of diesel power for steam power. It is interesting to note that the

net income of the Atlantic Coast Line in 1949, after payment of interest and income taxes, was about \$7,700,000. In March of this year, the Atlantic Coast Line arranged \$11,174,000 of financing to pay for an additional 73 diesel units from which they expect additional savings in operations. When these are delivered the Atlantic Coast Line estimates that 94% of their passenger train miles and 65% of their freight train miles will be diesel operated.

THE CHAIRMAN: We will adjourn now, Mr. Carson.

MR CARSON: Thank you, my lord.

---The Commission adjourned at 4:00 p.m., to meet again at 10:30 a.m. on Monday, April 24, 1950.

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